TRANSCRIPT OF RECORD.

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1900.

No. ~~204~~. 48

THE GUARANTEE COMPANY OF NORTH AMERICA, PETITIONER,

vs.

THE MECHANICS' SAVINGS BANK AND TRUST COMPANY, FOR THE USE OF J. J. PRYOR, ASSIGNEE.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

PETITION FOR CERTIORARI FILED APRIL 28, 1900.
CERTIORARI AND RETURN FILED MAY 21, 1900.

(17,731.)



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SUPREME COURT OF THE UNITED STATES.

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1 *Transcript of Record.*

In the Circuit Court of the United States for the Middle District of Tennessee, at Nashville, in said State.

At the April term, 1894, begun and held upon the third Monday of April, in said year, present and presiding the honorable the judges of the said circuit court of the United States, and at subsequent terms thereunto, the following proceedings were had, to wit:

On July 11th, 1894, during said April term, 1894, in the cause of—

THE MECHANICS' SAVINGS BANK & TRUST COMPANY, to the Use of J. J. Pryor, Assignee, etc.,
vs.
THE GUARANTEE COMPANY OF NORTH AMERICA.

Upon its removal from the chancery court of Davidson county, State of Tennessee, to the above-styled court, the following transcript from said chancery court was filed, to wit:

STATE OF TENNESSEE,
Davidson County.

Original Bill. Filed April 19, 1894.

In Chancery, at Nashville, Tennessee.

MECHANICS' SAVINGS BANK AND TRUST COMPANY
vs.
THE GUARANTEE COMPANY OF NORTH AMERICA ET AL.

To the Honorable Andrew Allison, chancellor, etc., holding the chancery court at Nashville, Tennessee:

2 The bill of complaint of The Mechanics' Savings Bank & Trust Company, a corporation chartered under the laws of the State of Tennessee, with its only office in Nashville, who sues to the use of James J. Pryor, assignee, *vs.* Union Bank & Trust Company, a corporation chartered under the laws of Tennessee, as administrator of John Schardt, and The Guarantee Company of North America, a foreign corporation chartered under the laws of the Dominion of Canada, with its chief office at Montreal and a branch office in Nashville, Tennessee, with Theo. Cooley, its local agent and manager.

Complainant shows that it is a corporation chartered under the laws of the State of Tennessee, as a savings bank and trust company, and as such has been doing business for several years.

That heretofore on the 17th day of April, 1893, it became insolvent, and was forced to close its doors, and ceased to do business, and it made a general assignment in trust to James J. Pryor, as-

signee, of all its assets, rights, credits, and property of every kind for the equal *pro rata* benefits of all its creditors.

Complainant states that said Pryor has accepted said trust after giving bond and qualifying as such under and according to the laws of Tennessee, and is now engaged in winding up the affairs of said bank and trust company, and the same is wholly insolvent and cannot pay the debts of said bank in full.

Complainant would further show that said bank while in existence received deposits, loaned money, discounted all manner of commercial paper, and had in its employ officers and clerks, such as cashiers, tellers, and book-keepers as well as president.

Complainant alleges and shows that John Schardt was from the 16th day of January, 1888, to January 1st, 1893, its teller and collector. And said Schardt was its cashier from January 1st, 1893, to the time the bank closed its doors, April 17th, 1893. That while he was filling said office of teller and performing the duties thereof, he was required to give bond and security to the bank to make good and reimburse it for all pecuniary losses sustained by the bank, by the fraudulent acts of said employé in connection with its said office and position, and other duties assigned him. And complainant says that said Guarantee Company of North America on the 16th day of January, 1888, gave its bond to complainant with Schardt as principal, and it as surety in the sum of $10,000 to expire on the 16th day of January, 1889, for a consideration paid to it, and to effect a continuance of said bond for the ensuing year or years a like consideration was to be paid to it, which
3 was done, and said consideration was paid on said bond continuous to the 16th day of January, 1893, for said John Schardt to make good and reimburse to said bank such pecuniary loss as it shall sustain by the fraudulent acts of said Schardt, in connection with its said office as teller and collector or with any other duties assigned to him by the bank in said service committed by him.

Complainant now shows to the court that after said bank made its assignment to said Pryor, assignee, expert book-keepers were employed to go over the books of the bank, and ascertain and report their condition especially the books of said Schardt, as teller and collector and as cashier aforesaid. Said Schardt departed this life at or near the time said bank closed, and the Union Bank and Trust Company became his executor and personal representative, and qualified as such according to law, and as such was requested to select a book-keeper, accountant and expert to examine said books and accounts in connection with two others, and the defendant, The Guarantee Company of North America, was also requested to select another expert accountant and book-keeper to act with the others in said matter.

The personal representative of said Schardt did select a book-keeper, who co-operated with the others, but the defendant, The Guarantee Company of North America, refused to do so, and the said book-keepers, accountants and experts, after several weeks of labor reported that said Schardt while acting in the capacity of teller,

collector, etc., had abstracted and fraudulently taken from said bank more than seventy thousand dollars, a large portion of which, say $50,856.77, he had abstracted and fraudulently taken during the year ending January 1st, 1893. So complainant charges that said Schardt during the currency of said bond by his fraudulent acts in connection with said office and position did take, embezzle and appropriate to his own use the sum of $78,956.11 with interest, and under the terms of said bond, defendant company, should reimburse said bank therefor; that said Schardt had no property out of which the same can be made, of all which facts complainant heretofore on the 20th day of April, 1893, gave notice to said guarantee company, and made proof thereof more than three months before bringing this suit and demanded payment thereof. And said company refuses to make any payment and denies its liability upon said bond.

Complainant further shows to the court that on January 1st, 1893, said Schardt was elected cashier of said bank, which office he filled to his death, some time in April, 1893; that when he
4 assumed said office said guarantee company for a consideration paid to it, executed and delivered its bond of that date to the complainant in the penal sum of $20,000, reciting that said Schardt had been appointed cashier of said bank, and had been required to furnish security that he shall not be guilty of any fraudulent act in the performance of his duties in the said capacity by which the said employer shall suffer any pecuniary loss, etc., agreed and did become security for said Schardt to the amount of any loss, not exceeding in the whole the sum of $20,000, which during the currency of said bond shall be sustained by the said employer by reason of any act of fraud committed by the said employé in connection with the duties of his said appointment and constituting embezzlement or larceny, such reimbursement to be made within three calendar months next after proof shall have been given to the satisfaction of the directors of said company of the loss.

Complainant now charges that said Schardt as such cashier and during the currency of said boud, did, as shown by the report of said experts, accountants and book-keepers, and did in fact by act of fraud, committed by him in connection with the duties of his said office and constituting embezzlement or larceny, take of said bank and appropriate to his own use the sum of $22,817.30, without interest and for which complainant is entitled to reimbursement under the terms and conditions of said bond.

Complainant states that it did give notice and make the proofs of the facts to said guarantee company, and did all other things required of it, under the terms and conditions of each of said bonds, and did give said notice and make proofs of loss more than three calendar months before the suit was brought and did make demand of payment according to the terms of said two bonds and the same was refused, said company claiming that it was not liable on said bond for any sum.

Complainant now files said two bonds as exhibits to this bill

marked Exhibit "A" & "B," and makes them a part hereof, but not to be copied.

Complainant further shows to the court that said Schardt a few days before his death assigned to complainant certain insurance policies upon his life as additional indemnity for the losses he had brought upon complainant by reason of his action aforesaid, to wit: A policy in the North Western Mutual Insurance Company for $10,000, which has been paid. A policy in the Ætna Insurance Company for $5,000, which has been paid. A policy in the
5 New York Life Insurance Company for $5,000, which has been paid, making a total of $20,000, which has been paid. Also he assigned the following policies which have not been paid, viz: Penn Mutual Life for $10,000; Mutual Life of New York for $25,000, and the U. S. Life of New York for $25,000, which has not been paid. Suit has been instituted on the last three named bonds, and defendants have filed pleas alleging that said policies are void by reason of frauds and concealments and false answers in respect to his health and amount of insurance then outstanding upon his life and deny all liability thereunder; how the same will end, of course complainant cannot foretell, but will prosecute the same to the end.

Complainant shows that said policies were accepted by it merely to be credited upon said bonds if collected. Twenty thousand dollars, as already stated has been collected, and sixty thousand remains uncollected. Said Schardt in making said assignment of said policies, knew his liability was very large to complainant, but did not know the amount thereof, nor did he give any order or direction in his said assignment as to which of said several bonds the moneys when collected should be applied, but made the assignment general to reimburse complainant for its losses by reason of his action as stated and complainant has applied the same in the order in which he embezzled the funds of the bank, that is to say, it has applied the first collection to the first embezzlement, and so on.

Complainant charges that he has taken, embezzled and appropriated under said several bonds as teller, etc., and cashier, the sum of $101,783.41, without interest being calculated thereon, and the whole of aforesaid policies do not exceed $80,000, and therefore if it can collect the whole of it it will still leave a large sum to be paid by the surety upon his several bonds.

Complainant further alleges that said defaults and embezzlement as made up of many hundreds if not thousands of items, is complicated, hidden and secreted, and is entirely too complex for a jury, or a court of law, and complainant files herewith a copy of the same as made out by said experts, book-keepers, — accountants as a correct statement of the same as it believes, and makes the same Exhibit "X" hereto, and a part of this bill, and charges that said defendants are indebted to it with interest thereon until paid.

Complainant asks that the court allow it to appropriate
6 any collection hereafter to be made, if any by said policies or otherwise in the order of the defaults and embezzlements. Complainant also asks that the court give judgment or decrees

against said parties for the full amounts of said two bonds; that it decree all necessary accounts, and make all necessary and proper interlocutory orders, and give it the proper and necessary and final decrees against each of defendants, such as the proof may show it entitled to.

And to this end it prays that process issue to said two parties named in the caption hereof making them defendants to this suit, and that they each be required to answer this bill, but not under oath, but under their respective seals, and it also prays all general and special relief.

EDWARD H. EAST, *Solicitor.*

The following bond was filed:

EXHIBIT "A" TO ORIGINAL BILL.

The Guarantee Company of North America.

Established 1872.

Head office, Montreal, Canada.

Bond No. 154,806. Amount, $20,000.

First premium up to Jan. 1, 1894, $100.

Annual premium payable January, $100.

Know all men by these presents: that John Schardt (hereinafter called the "said employé") and the Guarantee Company of North America (hereinafter called the "said company") are held and firmly bound unto Mechanics' Savings Bank and Trust Company, (hereinafter called the "said employer") in the sum of twenty thousand dollars, lawful money of the United States of America, to be paid to the said employer, his or their certain attorneys, executors, administrators, assigns or successors, to which payment well and truly to be made, we and each of us do bind ourselves, respectively, and our respective heirs, executors, administrators and successors, jointly and severally, firmly by these presents.

Sealed with our seals, and dated the first day of January, anno Domini one thousand eight hundred and ninety-three.

7 Whereas the said employé has been appointed cashier at Nashville, Tennessee, in the service of the said employer and has been required to furnish security that he shall not be guilty of any fraudulent act in the performance of his duties in the said capacity, by which the said employer shall suffer pecuniary loss, and whereas the said company, in consideration of the sum of one hundred dollars, now therefore paid for the term expiring January 1, 1894, and for the purposes of the renewal of this contract the sum or premiums of one hundred dollars, hereafter to be therefor paid to the said company, on or before the first day of January, 1894,

and a like payment for each and every succeeding term of one year, so long as the said company shall consent to receive it—hath agreed upon the terms, and subject to the provisos and conditions hereinafter contained and endorsed thereon, hereby to become such security to the said employer:

Now, therefore, this bond witnesseth, that the said employé for and on his own behalf and the said company fully relying on the truth of the statement and declaration contained in a certain document distinguished as employer's guarantee proposal No. 154,806, dated the 10th day of Jan., 1893, and signed Lewis T. Baxter, president on behalf of the said employer, and lodged with the said company at its office in Montreal, and on the strict performance and observance hereafter, by the said employer of the contract thereby created, do hereby, respectively, severally and jointly covenant with the said employer to reimburse unto the said employer or his or their representatives or assigns, the amount of any loss not exceeding in the whole the sum of twenty thousand dollars, which, during the currency of this bond, shall be sustained by the said employer by reason of any act of fraud committed by the said employé in connection with the duties of said appointment and constituting embezzlement or larceny—such reimbursement to be made within three calendar months next after proof shall have been given to the satisfaction of the directors of the said company, of the occurrence of such loss, and the proof thereof to include, if the company shall so require, an affidavit to be made or taken by the person, for the time being entitled to the benefit of this guarantee, to the effect that he hath been actually defrauded by the said employé, and that he suffers absolute and ultimate loss thereby to the full amount claimed hereunder, and that the contract created as aforesaid, hath been fully performed and observed on the part of the said employer.

Provided always, that this bond and guarantee hereby
8 granted or undertaken, shall be subject and liable to the terms and conditions hereupon endorsed.

And provided also, that this bond is granted upon the express understanding and agreement that if any other corporation, person or persons be or hereafter become security or surety for the said employé, in his employment as aforesaid (and concurrently with this bond), should any loss be occasioned to the said employer by the acts or defaults of the said employé, for which the said company is liable, under this bond, then the said employer shall be entitled only to demand from the said company, such proportion of the said loss as the amount guaranteed by this bonds bears to the whole security.

And it is also specially agreed hereby between the said employé, the said employer, and the said company, that if the said employé shall become a defaulter under circumstances which may afford ground for the laying of a criminal information against him, the said employer may and shall immediately take such steps as may be necessary, and within his or their power, to cause the detention or arrest of the said employé, pending an investigation of the de-

fault, and the substantiation or otherwise of any criminal offense, he may be suspected of having committed and which may entail loss or damage to the said employer, whereby a claim is liable to be made under this bond, and the said employer shall also immediately, on such default, coming to his or their knowledge, notify the said company, and if required so to do by the said company, or its representative shall, at the cost of the said company, afford and render every information, evidence, aid, and assistance, capable of being afforded by the said employer, either for the purpose of prosecuting, bringing to justice and convicting the said employé for any criminal offence which may be so substantiated, or for the purpose of enabling the said company to procure reimbursement by the said employé or by his estate, or moneys paid by or recoverable or claimed from the said company under this bond.

And provided, that the said company may upon giving one month's notice in writing to said employer, terminate this bond, in so far as concerns the acts or defaults of the said employé subsequent to the end of such month, remaining liable hereunder, for all acts covered by this bond, happening previous to such termination, and within the time specified in condition 6 hereof, for the space of three months after the date of such notice, and in the event of the said company so terminating this bond, it shall refund to the
9 said employer the proportion of the premium for the unexpired term of risk, but in case of premature termination of this contract by defalcation, the premium paid thereon shall be held to be fully earned and belong to the said company.

And the said employé doth hereby for himself, his heirs, executors and administrators, covenant and agree to and with the said company, that he will from time to time and at all times save, defend and keep harmless the said company from and against all loss and damage of whatsoever nature and kind, and from all legal and other costs and expenses, direct or incidental which the said company shall or may at any time sustain or be put to, whether before or after any legal proceedings by or against them and to recover under this bond and without notice to him thereof; or for or by reason or in consequence — the said company having entered into the present bond or guarantee.

And, lastly, should the said employé become a defaulter, and seek refuge in the Dominion of Canada, he hereby agrees to the enforcement against him of the laws of said Dominion as they may be now or hereafter enacted relative to the commission of injuries or offenses against a Canadian corporation.

In witness whereof the said John Schardt (the said employé) hath hereunto set his hand and seal; and the common seal of the said company and the signatures of the undersigned director and the

secretary of the said company are hereunto likewise respectfully attached and affixed the day and year above written.

Employé, JOHN SCHARDT. [SEAL.]
Director, E. RAWLINGS. [SEAL.]

ROBERT KERR,
Act. Secretary.

Signed, sealed and delivered by the said employé in the presence of—

J. M. EATHERLY.
JOHN A. McEWEN.
LEWIS T. BAXTER.

Endorsed: The Guarantee Company of North America.

Terms and Conditions Referred to in the within Bond.

This bond is granted upon the following express conditions:

1. Any misstatement of a material fact, in the declaration within mentioned, or in any claim made under this bond, will render this bond void from the beginning.

2. That the said employer shall use all due and customary diligence in the supervision of said employé for the prevention of default, and to that end shall cause an inspection or audit of his accounts to be made at least once within twelve months, and if the said employer shall at any time during the currency of this bond, become aware of any act or default on the part of said employé which would constitute a claim hereunder, and shall continue said employé in his service without notification to the said company, the said company will not be responsible hereunder for any loss or default which may occur subsequent to said act or default of said employé.

3. That any written answers or statements made by or on behalf of said employer in regard to or in connection with the conduct, duties, accounts or methods of supervision of the said employé delivered to the company either prior to the issue of this bond, or to any renewal thereof, or at any time during its currency, shall be held to be a warranty thereof, and form a basis of this guarantee, or of its continuance.

4. That the said employé has not, to the knowledge or belief of said employer, been guilty of any serious dereliction of duty, or default in this or any other service, or that his habits have been such as to incur said employer's censure, previous to the issue of this bond.

5. The said employer shall, immediately, upon it becoming known to him or them, that the said employé has been guilty of any act entitling the said employer to claim under this bond, notify the said company, at its head office; and this bond shall become absolutely void, both as to existing and future liability of the said employer, shall neglect or omit, to so notify the said company.

6. This bond shall extend to cover only such losses as may have been incurred by reason of the fraud of the said employé, dur-

ing the currency of this bond, and within twelve months previous to the notification to the said company of any default hereunder.

7. The liability of the said company hereunder *of the said company* shall cease three calendar months, from the expiry of this bond, or from the death of said employé, or from the date of said employé leaving the service within mentioned, or if the said employé be allowed to engage in any description of employment other than that specified in the declaration before referred to, or to
11 enter into business on his own account, without the sanction first obtained in writing from the said company.

8. That in addition to the supervision to be exercised by the said employer as mentioned in the statement and declaration within referred to the said company shall be afforded every reasonable facility to examine from time to time as they may desire, for the purposes of this bond, the books, papers and affairs of the said employer entrusted to the keeping and charge of the said employé.

9. The annual premium payable upon this bond must be paid within thirty days from the day on which it first accrues, due, and if paid within such thirty days, the bond shall be good and valid; but if not so paid, then (subject to a discretionary power in the directors to remit the forfeiture) the bond shall be absolutely void and all liability cease thereunder.

10. In case this bond be or become subject to any trust, the receipt of the trustee for the time being for the money which may become payable thereon, shall, notwithstanding any equitable claim or demand whatever of the person or persons beneficially entitled thereto, be an effectual and final discharge of the said company.

11. Printed official receipts issued from the head office for renewal premiums will alone be admitted as valid.

12. No suit or proceeding at law, or in equity, or arbitration, shall be brought to recover any sum hereby incurred, unless the same be commenced within one year from the time the said company is first notified of default.

Endorsed: Dated January 1st, 1893. Amount, $20,000. Filed July 11th, 1894. H. M. Doak, clerk, by E. L. Doak, deputy clerk.

The following bond was filed:

EXHIBIT "B," ORIGINAL BILL.

U. S. banks.

The Guarantee Company of North America.

Head office, Montreal, Canada.

Bond No. 93525.

Amount, $10,000.00. Annual premium, $100.

This bond, made the sixteenth day of January, one thou-
12 sand eight hundred and eighty-eight, between John Schardt, hereinafter called the "employé," of the first part, and the

Guarantee Company of North America, hereinafter called the "company," of the second part, and the Mechanics' Savings Bank and Trust Company (Nashville, Tennessee), hereinafter called the "employer," of the third part. Witnesseth:

Whereas, the employé has been appointed in the service of the said employer, and has been assigned to the office or position of teller and collector, by the said employer, and application has been made to the Guarantee Company of North America for the grant by them of this bond.

And whereas, the employer has delivered to the company a certain statement, and it being agreed and understood that such statement constitutes an essential part of the contract hereinafter expressed.

Now, therefore, in consideration of the sum of one hundred dollars lawful money of the United States of America, to the said company, as a premium for the term of twelve months, ending on the sixteenth day of January, 1889, at twelve o'clock, noon, and in order to effect a continuance of the currency of this bond, a like premium hereafter to be paid to the said company, on or before the sixteenth day of January in each year, as a premium for the ensuing year, so long as the said employer may wish to continue this bond, and the said company shall consent to receive said premiums, it is hereby agreed that the company shall, within three months after proof satisfactory to the directors, make good and reimburse to the employer such pecuniary loss as the employer shall have sustained by the fraudulent acts of the employé, in connection with the duties of his said office or position, or with any other duties assigned to him, by the employer in the said service, committed by him, and discovered during the continuance of the currency of this bond, and within six months from the employé's ceasing to be in the said service.

The following provisions are also to be observed and binding as a part of this bond:

The actual payment of the premium and its acceptance by this company either for the issue or renewal of this bond, is essential to its currency, and a condition precedent, to the right or claim hereunder.

That this bond is issued and renewed on the express understanding that the employé has not within the knowledge of the said employer at any former period either in this or other employment been guilty of any default or serious dereliction of duty.

13 That the employer shall observe or cause to be observed all due and customary supervision over the said employé for the prevention of default, and if the employer shall at any time, during the currency of this bond, condone any act or default, on the part of the employé, which would give the employer the right to claim hereunder, and shall continue the employé in his service, without notification to the company, the said company will not be responsible hereunto for any default which may occur subsequent to said act or default of said employé, so condoned.

That the employer shall at once notify the compnay, on his becoming aware of the said employé being engaged in speculation or

gambling, or indulging in any disreputable or unlawful habits or pursuits.

That there shall be an inspection or audit of the accounts or books of the employé on behalf of the employer at least once in every twelve months from the date of this bond.

That the company shall be notified in writing of any act on the part of said employé, which may involve a loss for which the company is responsible hereunder to the employer, immediately or without unreasonable delay, after the occurrence of such act shall have come to the knowledge of the employer; and upon the making of such a claim, this bond shall wholly cease and determine as regards any liability, for any act of the employé committed subsequent to the making of such claim, and shall be surrendered to the company on the payment of all claims due hereunder.

That, if the employer shall, at any time hold, concurrently with this bond, any other bond or guarantee of security, from or on behalf of the employé, the employer shall be entitled in the event of loss, by default of the employé to claim hereunder only such proportion of the loss as the amount covered by this bond bears to such other securities.

That the company may cancel this bond at any time, by notifying the employer and refunding the premium paid less a *pro rata* part thereof for the time said bond shall have been in force; but said cancellation shall not affect or impair, the company's liability hereunder for any acts committed or discovered previous to such cancellation during the currency of this bond, and within three months after said cancellation.

That no suit or proceeding at law or in equity shall be brought to recover any sum hereby insured, unless the same is com-
14 menced within twelve months (365 days) from the time any claim hereunder shall have been first made. That the company shall not in anywise be responsible to the employer under this bond to a greater extent than ten thousand dollars.

And it is also specially agreed hereby between the said employé, the said employer and the said company, that if the said employé shall become a defaulter under circumstances for which the said employer intends making claim upon the said company, the said employer may and shall at the cost of the said company, immediately cause the detention of the said employé pending an investigation of a default; and if the said employer shall also immediately on such default coming to his or their knowledge notify the said company, and if required so to do by the said company, or its representative shall, at the cost of the said company, afford and render every information, evidence, aid and assistance capable of being afforded by the said employer for the purpose of prosecuting the said employé for any criminal offense, which may be substantiated, or for the purpose of enabling the said company to procure reimbursement by the said employé, or by his estate, or moneys paid by, or recoverable from the said company, under this bond, at any time either before or after paying any claim made on the said company under this bond. And if after any such arrest or detention of the

said employé based upon any default he may have committed, should be made, and upon investigation, no criminal act shall be substantiated, the said employé hereby waives any right of action against the said employer or the said company, for any damages arising from such arrest or detention.

And the said employé doth hereby for himself, his heirs, executors and administrators, covenants and agrees to and with the said company, that he will save, defend and keep harmless the said company from and against all loss and damage of whatever nature and kind, and from all legal, and other costs and expenses, direct or incidental, which the said company shall or may at any time sustain or be put to, whether before or after any legal proceedings by or against him, to recover under this bond, and without notice to him thereof or for, or by reason or in consequence, of the said company, having entered into the present bond, and in any suit or proceedings by the said company, or by the said employer on their behalf, to recover any sum of money, from the said employer, or from his estate, the amount which the said employer shall have claimed under this bond, shall until controverted by sufficient proof, be held to be the amount of claim as against the said employé, and due by him to the said company.

And lastly, should the said employé, seek refuge in the Dominion of Canada, after having become a defaulter, under this bond, he hereby agrees to the enforcement against him, of the laws of said Dominion, as they now—or may be hereafter enacted, relative to the commission of injuries, or offenses, against a Canadian corporation.

In witness whereof, the said John Schardt, (the said employé) hath hereunto set his hand and seal, and the said company hath caused this bond to be signed by one of its directors, and by its secretary, and its seal to be hereunto affixed, this sixteenth day of January, one thousand eight hundred and eighty-eight.

JOHN SCHARDT, *Employé.*
E. RAWLINGS, *Director.*
[SEAL.] ROBERT KERR,
Act. Secretary.

This bond, with conditions and provisions, is hereby accepted and the contract effected thereby acknowledged.

C. W. PEDEN, *Employer.*

Endorsed: Filed July 11, 1894. H. M. Doak, clerk, by E. L. Doak, deputy clerk.

Exhibit "X" to Original Bill.

Statement of Shortage of Jno. Schardt, Cash. and Teller of the Mechanics' Savings Bank & Trust Co.

					Interest to April 15, '93.
1890.					
Sept.	12.	Cash Book, page 143, adding disc'ts.	5 00		76
Oct.	9.	" " 189, " cash book.	900 00		135 90
Nov.	8.	" " 241, " "	600 00		87 60
	10.	" " 243, disc't error putting down 9,366.	1,000 00		145 67
	11.	" " 245, adding cash book.	100 00		14 55
	26.	" " 271, adding cash book.	500 00		71 58
1891.					
Jan.	17.	" " 56, adding Com'l Bk	100 00		13 47
	23.	" " 67, transferring ch'ks to E. B.	50 00		6 67
Feb.	20.	" " 114, adding C. B.	500 00		64 67
April	9.	" " 195, trans. ch'ks to E. B.	500 00		60 50
	11.	" " 199, trans. ch'ks to C. B.	500 00		60 40
	18.	" " 211, adding C. B.	500 00		59 75
	23.	" " 219, " "	300 00		35 60
	25.	" " 223, " "	300 00		35 50
May	11.	" " 248, " "	400 00		46 24
	23.	" " 23, trans. ch's to E. B.	1 00		10
16					
June	1.	" " 35, adding E. B.	500 00		56 25
	10.	" " 50, " Com'l Bk	200 00		30 16
	13.	" " 57, " cash book	400 00		44 15
	15.	" " 59, " "	200 00		22 00
	18.	" " 65, " "	200 00		21 90
	19.	" " 67, " "	100 00		10 93
	20.	" " 69, " "	300 00		32 75
	22.	" " 71, " "	400 00		42 53
	23.	" " 73, " "	200 00		21 75
	26.	" " 79, " "	200 00		21 64
	29.	" " 83, " "	100 00		10 77
July	9.	" " 99, " "	1,000 00		106 00
	21.	" " 119, " "	200 00		20 83
Aug.	3.	" " 141, " "	200 00		20 40
	6.	" " 147, " "	200 00		20 30
	10.	" " 153, " "	200 00		20 17
	11.	" " 155, " "	200 00		20 14
		Forward.	11,056 00		1,361 63
1891.		Forward.	11,056 00		1,361 63
Aug.	12.	Cash Book, folio 157, adding cash book	200 00		20 12
	15.	Cash Book, folio 163,	100 00		10 02
	17.	Cash Book, folio 165,	100 00		9 96
	18.	Cash Book, folio 167,	100 00		9 95
	22.	Cash Book, folio 175,	300 00		29 95
	26.	Cash Book, folio 181,	100 00		9 81
	31.	Cash Book, folio 189,	100 00		9 73
Sept.	1.	Cash Book, folio 191,	200 00		19 23
	2.	Cash Book, folio 193,	200 00		19 20
		Cash Book, folio 192, " Com'l bank	30 00		2 90
	4	Cash Book, folio 197, " cash book	200 00		19 14
	24.	Cash Book, folio 229,	200 00		18 66
	25.	Cash Book, folio 231,	200 00		18 63
	28.	Cash Book, folio 235,	100 00		9 30
	29.	Cash Book, folio 237,	200 00		18 55
Oct.	1.	Cash Book, folio 241,	300 00		27 75
	2.	Cash Book, folio 243,	200 00		18 45
	3.	Cash Book, folio 245,	500 00		46 15
	6.	Cash Book, folio 249,	200 00		18 40

	7.	Cash Book, folio 251,	400 00	36	75
	8.	Cash Book, folio 253,	300 00	27	65
	15.	Cash Book, folio 265,	200 00	18	00
	17.	Cash Book, folio 269,	100 00	8	95
	20.	Cash Book, folio 273,	100 00	8	90
	22.	Cash Book, folio 277,	100 00	8	85
	24.	Cash Book, folio 281,	200 00	17	60
	26.	Cash Book, folio 283,	200 00	17	55
	27.	Cash Book, folio 285,	300 00	26	35
	28.	Cash Book, folio 287,	200 00	17	50
	29.	Cash Book, folio 289,	400 00	34	90
	30.	Cash Book, folio 291,	200 00	17	45
	31.	Cash Book, folio 293,	300 00	26	25
Nov.	2.	Cash Book, folio 295,	300 00	26	20
	3.	Cash Book, folio 297,	200 00	17	40
	4.	Cash Book, folio 299,	200 00	17	38
	5.	Cash Book, folio 3,	300 00	26	15
			18,586 00	2,051	36
	6.	Cash Book, folio 5,	200 00		
	7.	Cash Book, folio 7,	200 00		
	9.	Cash Book, folio 9,	200 00		
	10.	Cash Book, folio 11,	200 00		
	11.	Cash Book, folio 13,	200 00		
17	12.	Cash Book, folio 15,	200 00		
	13.	Cash Book, folio 17,	100 00		
Nov.	16.	Cash Book, folio 21, adding cash book	100 00		
	17.	Cash Book, folio 23,	100 00		
	18.	Cash Book, folio 25,	300 00		
	19.	Cash Book, folio 27,	200 00		
Dec.	1.	Cash Book, folio 45,	200 00		
	2.	Cash Book, folio 47,	300 00		
	3.	Cash Book, folio 49,	100 00		
	7.	Cash Book, folio 55,	400 00		
	8.	Cash Book, folio 57,	200 00		
	9.	Cash Book, folio 59,	200 00		
1892.					
Jan.	18.	Cash Book, folio 123,	200 00		
	19.	Cash Book, folio 125,	200 00		
	20.	Cash Book, folio 127,	600 00		
	22.	Cash Book, folio 131,	200 00		
	23.	Cash Book, folio 133,	400 00		
	25.	Cash Book, folio 135,	400 00		
	26.	Cash Book, folio 137,	300 00		
	27.	Cash Book, folio 139,	200 00		
	28.	Cash Book, folio 141,	500 00		
	30.	Cash Book, folio 145,	200 00		
Feb.	1.	Cash Book, folio 147,	300 00		
	2.	Cash Book, folio 149,	300 00		
1892.					
Feb'y	3.	Cash Book, folio 151, adding cash book	100 00	7	20
	4.	Cash Book, folio 153,	500 00	35	90
	5.	Cash Book, folio 155,	100 00	7	17
	6.	Cash Book, folio 157,	100 00	7	15
	10.	Cash Book, folio 163,	300 00	21	35
	15.	Cash Book, folio 170, carrying cash for'd	20		
			26,886 20	2,695	78
Mar.	2.	Cash Book, folio 197, adding cash book	200 00	13	40
	4.	Cash Book, folio 201,	300 00	20	07
	5.	Cash Book, folio 203,	500 00	33	33
	8.	Cash Book, folio 207,	400 00	26	45
	10.	Cash Book, folio 211,	500 00	33	00
	11.	Cash Book, folio 213,	300 00	19	70
	14.	Cash Book, folio 217,	200 00	13	00
	16.	Cash Book, folio 221,	300 00	19	45

	17.	Cash Book, folio 223, ...	200 00	12 90
	18.	Cash Book, folio 225, ...	100 00	6 43
	22.	Cash Book, folio 231, ...	300 00	19 37
	23.	Cash Book, folio 233, ...	300 00	19 34
Mar.	25.	Cash Book, folio 237, adding cash book.....	100 00	6 43
	26.	Cash Book, folio 239, ...	100 00	6 41
Apr.	6.	Cash Book, folio 257, ...	300 00	18 45
	7.	Cash Book, folio 259, ...	1,000 00	61 33
	8.	Cash Book, folio 261, ...	1,000 00	61 17
	9.	Cash Book, folio 263, ...	300 00	18 30
	11.	Cash Book, folio 265, ...	200 00	12 13
	12.	Cash Book, folio 267, ...	300 00	18 19
	13.	Cash Book, folio 269, ...	300 00	18 16
	16.	Cash Book, folio 273, ...	100 00	6 00
	18.	Cash Book, folio 275, ...	1,000 00	59 50
	25.	Cash Book, folio 287, ...	200 00	11 66
	26.	Cash Book, folio 289, ...	500 00	29 08
	27.	Cash Book, folio 291, ...	500 00	29 00
Apr.	30.	Cash Book, folio 297, adding cash *bor*.....	200 00	11 50
May	2.	Cash Book, folio 299, ...	500 00	29 58
	3.	Cash Book, folio 301, ...	200 00	11 40
	4.	Cash Book, folio 303, ...	200 00	11 37
18	6.	Cash Book, folio 307, ...	100 00	5 65
	23.	Trnsfrg. ch'ks, 332, to cash book.....	69 30	3 70
June	13.	Cash Book, folio 367, adding C. B....	500 00	25 15
	15.	Cash Book, folio 371, ...	600 00	30 00
	16.	Cash Book, folio 373, ...	200 00	9 90
	20.	Cash Book, folio 379, ...	400 00	19 60
			39,355 50	3,445 88
	25.	Cash Book, folio 389, ...	300 00	14 50
	27.	Cash Book, folio 391, ...	300 00	14 44
July	18.	Cash Book, folio 29, ...	500 00	22 25
	21.	Cash Book, folio 35, ...	1,000 00	44 00
	23.	Cash Book, folio 39, ...	1,000 00	43 67
	25.	Cash Book, folio 41, ...	200 00	8 66
	27.	Cash Book, folio 45, ...	1,000 00	43 00
	28.	Cash Book, folio 47, ...	500 00	21 41
	29.	Cash Book, folio 49, ...	200 00	8 53
	30.	Cash Book, folio 51, ...	500 00	21 25
Aug.	1.	Cash Book, folio 53, ...	200 00	8 50
	3.	Cash Book, folio 57, ...	1,000 00	42 17
	4.	Cash Book, folio 59, ...	500 00	21 00
	6.	Cash Book, folio 63, ...	400 00	16 60
	10.	Cash Book, folio 69, ...	200 00	8 22
	20.	Cash Book, folio 87, ...	300 00	11 75
	26.	Cash Book, folio 97, ...	500 00	19 08
Sept.	1.	Cash Book, folio 107, ...	500 00	18 75
	14.	Cash Book, folio 127, ...	1,000 00	35 00
Sept.	27.	Cash Book, folio 149, Com'l bank.....	10 00	32
	30.	Cash Book, folio 155, cash book.....	1,000 00	30 00
Oct.	2.	Cash Book, folio 159, ...	1,000 00	29 67
	6.	Cash Book, folio 165, add. cash book.....	1,000 00	29 00
Nov.	5.	Cash Book, folio 215, ...	1,000 00	28 00
	7.	Cash Book, folio 217, ...	1,000 00	27 67
	12.	Cash Book, folio 225, ...	2,000 00	51 00
	15.	Cash Book, folio 229, ...	1,000 00	25 00
	16.	Cash Book, folio 231, ...	1,000 00	24 83
	17.	Cash Book, folio 233, ...	500 00	12 39
	19.	Cash Book, folio 237, ...	1,000 00	24 50
	22.	Cash Book, folio 241, ...	1,000 00	24 00
	23.	Cash Book, folio 243, ...	500 00	11 83
			61,465 50	4,186 87
	25.	Cash Book, folio 245, ...	2,000 00	46 66
Dec.	1.	Cash Book, folio 255, ...	1,000 00	22 50

	2.	Cash Book, folio 257,	800 00	17 76
	6.	Cash Book, folio 263,	500 00	10 75
	7.	Cash Book, folio 265,	600 00	12 80
	8.	Cash Book, folio 267,	200 00	4 25
	9.	Cash Book, folio 269,	600 00	12 65
	13.	Cash Book, folio 275,	1,000 00	20 33
	17.	Cash Book, folio 283,	2,000 00	39 35
	20.	Cash Book, folio 287,	1,000 00	19 17
	22.	Collected of C. H. Brandon on note No. 11479; cr. on note but not on cash book	250 00	4 75
	28.	Cash Book, folio 299, adding C. B	1,000 00	17 33
1893.				
Jan'y	28.	Cash Book, folio 351,	2,000 00	25 66
	30.	Cash Book, folio 353,	1,000 00	12 50
	31.	Cash Book, folio 355,	2,000 00	25 00
Feb'y	1.	Cash Book, folio 357,	1,000 00	12 33
	3.	Cash Book, folio 361,	2,000 00	24 00
M'ch	6.	Cash Book, folio 413,	05	
	11.	Collected on note M. A. Consadine, No. 11736; cr. on note but not on cash book	65 00	32
19				
	23.	Cash Book, folio 441, adding cash book	1,000 00	3 67
M'ch	24.	Cash Book, folio 442, adding disc'ts	50 00	15
		Cash Book, folio 443, cash book	1,000 00	3 50
	25.	Cash Book, folio 445,	500 00	1 67
	27.	Cash Book, folio 447,	500 00	1 50
	31.	Collected on D. L., Jno. Thompson, $576—cr. on D. L., but not on cash book	590 00	2 95
Ap'l	13.	Collected on A. W. McClure, D. L., $590—cr. on D. L., but not on cash book	25 00	
1890.				
Aug.	10.	Collected bal. note 7748, W. C. McCann—no cr.	301 13	48 43
Ap'l	19.	7815, A. B. Payne, F. C. Elliott—no cr	200 00	32 80
May	5.	7839, T. J. Hough	150 00	24 45
		7863, Chas. S. Martin	200 00	32 20
		7899, J. T. Lannom	100 00	16 50
		7942, J. H. Reeves	90 00	14 31
			85,186 68	4,697 11
		Collected on note 7947, J. H. Wood—no cr. E. B.	500 00	81 75
		7971, W. H. & G. W. Bliss	100 00	16 20
		8063, E. & N. Mfg. Co	444 31	72 86
		9046, P. G. Gordon	500 00	74 33
		10111, R. A. Wilson	50 00	7 90
		10688, Mrs. S. F. Richardson	25 00	3 24
		10177, Ida Kain	35 00	3 30
		11312, J. H. Hendricks, bal	10 00	93
		11333, Claud Wilson	50 00	1 62
		11791, Jno. A. Baxter, bal	10 08	09
		11876, M. S. Kahn	2,500 00	14 58
1893,				
Jan'y	24.	Discount collected of Cleburne Club and not cr. on C. B	2 80	03
M'ch	15.	J. E. Burch, check	600 00	3 00
	17.	(2) " 500		
		500		
			1,000 00	4 66
	17.		900 00	4 20
	18.	2,767 35		
		Less deposit 725 00		
			2,042 35	9 19
	18.		600 00	2 70
1893.				
M'ch	20.	(2) checks 725 00		
		125 00		
			850 00	3 54

	16.	Deposit C. B Duncan not entered on E. B.	1,200 00	5 00
	6.	Deposit House Bldg. & L. Ass'n entered on E. B.	43 90	29
	17.	Deposit	9 00	04
	27.	Deposit	11 47	04
Feb'y	17.	Deposit N. B. Freeman, cl'k	90 00	85
1893.				
Aug.	30.	Deposit H. A. Phipps	25 00	97
Sept.	20.	Deposit do.	138 00	4 71
1893.				
M'ch	9.	Deposit Security Home B. & L.	100 00	60
	10.	Deposit	30 00	17
	27.	Deposit	300 00	90
Apr.	3.	Deposit	5 00	
M'ch	18.	Shortage in cr. to Security Home B. & L. Ass'n.	148 50	67
	13.	Collected of Jno. Spencer—cr. on note belonging to Frank L. Morton, not cr. to his %	20 00	10
		Collected on note 11736, M. A. Consadine, not cr. on cash book	30 00	
			97,557 01	5,016 37
20		Collected by Jno. Schardt cash of the following parties for the credit of % of Security Home Bldg. & L. Ass'n, entered on the different pass books, but not placed to credit of the % on bank's books, viz:		
		Book No.—		
		2409, Williams, G. M.	5 00	
		399, Beal, Mrs. E	1 50	
		2228, Tanner, Samuel	6 64	
		2422, Mince, M. E	20	
		682, McKeand, Sr. W.	10 00	
		2232, Gray, A. R.	18 25	
		2401, Hertenstein & wife, J. G.	4 28	
		2233, Phipps, H. A.	85 00	
		2233, Phipps, H. A.	26 00	
		791, Gwynne, Miss Mary—balance entered on her book, $5.75; correct amount, $575.00	569 25	
1890.				
May	22.	Check Book, folio 539, adding Book No. 4	10 00	1 75
1891.				
Ap'l	6.	Check Book, folio 513, adding Book No. 5	1,000 00	121 50
Sept.	1.	Check Book, folio 207, adding Book No. 6	1 00	10
Dec	15.	Check Book, folio 428, adding Book No. 6	100 00	8 00
	21.	Check Book, folio 437, adding Book No. 6	10 00	78
1892.				
Jan'y	13.	Check Book, folio 487, adding Book No. 6	10 00	75
Feby	17.	Check Book, folio 563, adding Book No. 6	10 00	70
May	25.	Check Book, folio 171, adding Book No. 7	10 00	53
June	30.	Check Book, folio 256, adding Book No. 7	20 00	95
July	6.	Check Book, folio 271, adding Book No. 7	10 00	46
Oct.	6.	Check Book, folio 464, adding Book No. 7	10 00	31
1890.				
July	24.	Error adding Deposit Book 5, folio 15	1 00	15
Aug.	1.	Error adding Deposit Book 5, folio 23	100 00	16 50
1891.				
M'ch	9.	Error adding Deposit Book 5, folio 303	500 00	63 00
	21.	Error adding Deposit Book 5, folio 318	100 00	11 90
Ap'l	7.	Error adding Deposit Book 5, folio 343	500 00	60 66
			100,675 13	5,304 41
	8.	Error adding Deposit Book 5, folio 344	1,000 00	121 30
	9.	Error adding Deposit Book 5, folio 346	500 00	60 55
1892.				
Ap'l	28.	Error adding Deposit Book 7, folio 70	2 00	10
May	31.	Error adding Deposit Book 7, folio 122	1 00	05

Sept. 19.	Error adding Deposit Book 7, folio 277			100 00	3 43
1893.					
Jan'y 16.	Error adding Deposit Book 8, folio 64			8 00	12
				102,286 13	5,489 96

Creditors.

1890.					
Feb'y 12.	Adding C. B., folio 85			$10 00	$
1891.					
June 11.	Transferring ch'ks to E. B., folio		52..	2 00	20
Aug. 8.	Adding C. B. Com'l bank		150..	300 00	30 35
1892.					
June 29.	Transferring ch'ks to E. B.		395..	5 70	27
Dec. 14.	Transferring ch'ks to C. B.		276..	9 90	19
1893.					
Jan. 7.	Adding ind. deposits		314..	22	
Jan. 16.	Adding ind. deposits		328..	8 00	12
Mar. 2.	Adding ind. deposits		404..	3 00	03
21					
Mar. 8.	Adding Com'l bank		415..	1 00	
Mar. 18.	Carrying deposits to C. B.		433..	10 00	06
Mar. 24.	Adding C. B.		442..	2 00	
1890.					
Oct. 8.	Error adding Check Book No. 5		164..	100 00	15 11
1891.					
Jan. 5.	Error adding Deposit Book No. 5		215..	2 00	22
1892.					
Sept. 5.	Error adding Deposit Book No. 7		254..	100 00	3 50
				$543 92	$50 05

Recapitulation.

Amount shortage	$102,286 13	
Interest on same	5,489 96	
		$107,776 09

Credits.

Amount credits	$543 92	
Interest on same	50 05	
		593 97
		$107,182 12
1893.		
Mar. 8. Eakin Spencer deposit not entered to his credit		41 20
Net am't shortage Jno. Schardt, cash. and teller		$107,223 32

This item reported after report of experts was made.

Answer.

The separate answer of the Guarantee Company of North America to the bill of complaint filed against it and another by the Mechanics' Savings Bank & Trust Company for the use of J. J. Pryor, assignee, in the chancery court at Nashville, Tennessee, and removed upon petition to this honorable court.

Respondent for and to so much and such parts of said bill, as it is advised is material for it to answer, answering says:

(1.) Respondent admits that the Mechanics' Savings Bank & Trust Company is a corporation chartered under the laws of the State of Tennessee as a savings bank and trust company, and has been doing

business for several years. It admits that upon April 17th, 1893, said corporation became embarrassed, closed its doors, ceased to do business, and made a general assignment to James J. Pryor for the equal benefit of all its creditors. It admits that said Pryor has accepted the trust, qualified as assignee, and is now engaged in closing up its affairs. It is also admitted that the bank while in operation received deposits, loaned money, discounted paper and had officers, clerks, cashiers, tellers, and book-keepers, as well as a president.

22 (2.) Respondent admits that John Schardt was the teller of said bank from the 16th day of January, 1888, to the first of January, 1893, and was cashier of said bank from January 1st, 1893, to April 17th, 1893.

(3.) Respondent admits that on the 16th day of January, 1888, it executed a bond to the bank with Schardt as principal and it as surety in the sum of $10,000, to expire January 16th, 1889, unless continued, and that upon paying proper considerations, and the making of certain important and material representations, said bond was continued in force to January 16th, 1893, but the bond itself is referred to for its terms, conditions and limitations.

(4.) Respondent admits that after said bank made its assignment to said Pryor, its affairs were examined, and it was discovered that said Schardt had abstracted from said bank a large amount of its money, a part of which was abstracted in the year 1890, a part in 1891, and a part in 1892, and a part in 1893, but respondent does not admit that the amounts embezzled in each year are correctly stated in the bill.

(5.) Respondent admits that prior to the death of said Schardt he assigned to the bank certain insurance policies upon his life for the purpose of paying off and discharging all of his indebtedness to said bank, but just what insurance and what amounts he assigned respondent is unable to state because it does not know.

Respondent admits that a large amount of said insurance money has been collected, and that a large amount is now in litigation, and respondent concedes the right of complainant to apply the moneys received from said insurance to the indebtedness of said Schardt in the way it has been done; that is, the first money received has been applied to the first money abstracted from the bank by said Schardt; and respondent avers that there will be collected from said insurance policies more than a sufficient amount to pay off and discharge all the money abstracted by said Schardt prior to January 1st, 1893.

First. Respondent denies any liability under the teller's bond, for the following reasons, among others:

(1.) Respondent avers that while said bond insured the bank against loss on account of the fraudulent acts of said Schardt as teller and collector, and while respondent only agreed to bond said Schardt as teller and collector, yet he was permitted to perform the duties of general book-keeper in addition to his duties as teller and collector, and it was by reason alone of these extra and addi-

23 tional duties being imposed upon him that he was enabled to *do* and did embezzle the bank's funds, and continued to do

so through a long period of time; and but for the bank imposing these additional duties on said Schardt he would not and could not have embezzled its funds.

And respondent did not guarantee Schardt to said bank in the capacity of general book-keeper, nor in the dual capacities of "teller and collector" and "general book-keeper," nor in any other capacity than as teller and collector, and respondent is therefore not liable to the bank under its said bond for any fraudulent act of said Schardt in connection with his duties as teller and collector and general book-keeper, and respondent denies that said Schardt caused said bank any loss whatever, prior to January 1st, 1893, except such loss as accrued while he acted in such dual capacity as teller and collector and general book-keeper, and denies that said Schardt caused the bank any loss by any fraudulent act in connection with his duties as teller and collector solely.

(2.) Respondent avers that the shortage during 1890 and 1891 has been fully paid and discharged by the insurance money received by the complainant, and it is not liable for any shortage during the year 1892 or the year 1891 (even though the shortage for the year 1891 had not been thus made good), because said bank procured said bond to be continued in force from and after January 16th, 1889, from year to year thereafter, by stating to respondent annually in each year, that the accounts of said Schardt had been examined and verified and were correct, and relying upon the truth of such statements which were warranties, and without which said bond would not have been continued in force, respondent continued said bond in force; whereas, the statements so made in each year were false and fraudulent, and as ascertained by respondent since his claim was made, no examination of said accounts had ever been made as represented, and the same had never been verified, and never found correct, but on the contrary a large shortage existed in said accounts at the time each of said statements were made in 1891 and 1892; and had such examination and verification been so made as represented, said shortage would have been at once discovered, and said bond would not have been continued in force by respondent.

And respondent also avers that said bond was issued upon the faith of the representations and agreements by the bank amounting to the warranty thereof, that the cash of said Schardt as teller would be checked and counted quarterly by the finance committee
24 of the bank, and which by the terms of said bond was required to be done, but which, as respondent has ascertained since the making of this claim, was not done, or, if done, was so negligently and inefficiently done as to be worthless, and for which reason respondent denies any liability under said bond.

(3.) Respondent further avers that said bond provided that immediate notice should be given to respondent of any gambling or speculating on the part of said Schardt, and avers that during the continuance of said bond the officers of said bank became aware of the fact that said Schardt was not only speculating himself, but was interested in a concern in which speculation was the sole business; and said officers of said bank, notwithstanding that they specially

censured Schardt for such conduct, not only did not notify respondent thereof, but concealed the same from it.

(4.) On or about January 1st, 1893, complainant represented and stated to respondent that it had examined and verified the accounts of said Schardt as teller and collector and found the same to be correct, and respondent was not notified prior to January 16th, 1893, that there was any shortage whatever, nor was it so notified until the latter part of April, 1893, and more than ninety days after the employé, the said Schardt, had ceased to be in the service of said bank as teller and collector, and more than ninety days after said bond on Schardt as teller and collector had expired, nor was the shortage discovered during the continuance of the currency of said bond or respondent notified thereof, as required by the bond, and it pleads these facts in bar of any right of action against it on account of said teller's bond.

Respondent for further answer says that the complainant did not make a proper inspection or audit of the books and accounts of said Schardt once each year as required by said bond, and this condition of the teller's bond was breached by the complainant.

The complainant did not use the proper and customary diligence in the prevention of a default while said teller's bond was in force, and this condition of said bond was breached by the complainant.

Second. Respondent denies any liability under said cashier's bond for these reasons, among others:

(1.) Said bank made application to respondent for a bond on said Schardt as cashier on or about January 1st, 1893, and in order to secure said bond from respondent, it falsely and fraudulently represented to respondent, among other things, that the accounts
25 of said Schardt as teller had been examined and verified, and that his conduct had at all times been satisfactory, while in fact said Schardt had at that time embezzled from the bank nearly twice the amount of its entire capital, which fact was known, or could with slight investigation have been known to the officers of said bank, and which facts were material to be known, and respondent relied upon said statements, and they formed the basis of the issue of the bond, which would not have been executed but for such statements and warranties. Respondent did not know these facts and they were not such facts as could have been known to any one except the officers of said bank.

(2.) The officers of said bank concealed from respondent the fact that said Schardt had been speculating, which fact was unknown to respondent, and the bond was issued upon said Schardt as cashier upon the express condition that he had not been guilty of any serious dereliction of duty, and that his habits had been such as not to incur the censure of said bank, while in fact said Schardt had not only been derelict in his duties, but his habits in respect to gambling or speculating had been such as not only to justify, but to actually receive the severe censure of the officials of said *bond*, and this too, before said bond was applied for or issued; these facts were not stated to respondent but concealed from it, and but for such concealment respondent would not have issued said bond.

(3.) Respondent further avers that also said bank in making application for said bond upon said Schardt as cashier stated that he would perform the duties of cashier only, and the bond was so executed, yet said bank at the time knew and expected said Schardt to perform the duties of general book-keeper, and thereafter did permit him to perform such duties in addition to his duties as cashier, and it was only by reason of the fact that he was permitted to perform these additional duties in connection with his duties as cashier, that he was enabled to embezzle the funds of the bank, and for this reason respondent denies all liability upon said bond, and avers that it would not have entered into said bond but for the representations of said bank that said Schardt would not be permitted or expected to perform the duties other than those of cashier.

(4.) Respondent further avers that in the application for the issuance of said cashier's bond, said bank caused its president to certify to respondent that no former cashier of said bank had ever been short in his accounts, when in fact a former cashier had been
26 short in his accounts, which fact was well known by the officers of said bank, and concealed from respondent.

All statements and certifications made by the bank to respondent in connection with the teller and collector's bond were intended to be and were in fact warranties, and they were made for the purpose of securing and continuing in force the said bond; and the answers and representations in the application made by the said bank to respondent for the issue of the bond on said Schardt, as cashier, were also warranties and likewise made for the purpose of securing said cashier's bond.

Respondent avers that the action of said bank and the false and fraudulent statements made to respondent by it with respect to continuing in force said teller's bond *has* released respondent from liability, and the false and fraudulent statements, the concealment of material facts with respect to said cashier's bond, and the additional opportunities afforded said Schardt to defraud the bank by performing the duties of general book-keeper *has* released respondent *for* all liability thereunder.

And respondent, further answering, avers that the officers and directors of the complainant bank misrepresented to it the financial condition of said bank, and from time to time, beginning in the year 1888 down to the time said bank ceased to do business, it represented to respondent and published to the world financial statements of its condition, which were false and known to be false when so made and published.

Respondent avers that it relied upon said statements and misrepresentations, and the same were material to be known, and it would not have continued in force said teller's bond, nor issued said cashier's bond, but for such statements being made to it and published as aforesaid.

Respondent avers that it executed both said bonds in good faith for the purposes therein expressed, but it is advised that the bank also had duties to perform with respect to each of said bonds and respondent's rights therein; and respondent avers that since the

bank has failed to perform its duties under and with respect to each of said bonds, therefore it has no right in equity or good morals to compel payment for losses occasioned through its own neglect and wrongs.

The statements, representations and warranties of the bank to respondent were accepted in good faith and acted upon; respondent was wholly ignorant of the true facts and could not have discovered them except through the bank, since such facts were peculiarly within the keeping of the bank.

27 Respondent is advised that the bank is entitled to recover the premium paid for the cashier's bond, which is $100.00, and which has heretofore, to wit, on December 28th, 1893, been tendered to the complainant and refused; and respondent stands ready to make good said tender as directed by the court and to pay such other amounts on account of premiums received by it as may be just.

Respondent denies all allegations in the bill not admitted to be true, and, having fully answered, prays to be hence dismissed with its reasonable cost.

GRANBERY & MARKS, *Solicitors.*

(Endorsed:) Filed July 11, 1894. H. M. Doak, clerk, by E. L. Doak, D. C.

Subpœna to Answer. Issued May 29, 1894.

STATE OF TENNESSEE:

To the sheriff of Davidson county, Greeting:

We command you to summon the Union Bank & Trust Company, administrator of John Schardt, deceased; the Guarantee Company of North America, if to be found in your county, to appear before the chancellor of the chancery court at Nashville, at the court to be held at the court-house in Nashville, on the second Monday in June next, it being the 11th day of June, 1894, then and there to answer the original bill of Mechanics' Savings Bank & Trust Company *versus* The Union Bank & Trust Company, adm'r, *et al.*, and further do and receive what our said court shall consider in that behalf; and this you shall in nowise omit, under the penalty prescribed by law. Herein fail not, and have you then and there this writ.

Witness George K. Whitworth, clerk and master of our said chancery court, at office in the court-house at the city of Nashville, this first Monday in April, 1894, and the 118th year of American Independence.

G. K. WHITWORTH,
Clerk and Master,
By J. R. WEST, *D. C. & M.*

Sheriff's Return.

Came to hand the same day issued, and returned executed by reading and making known the contents of the within pro-
28 cess to Edgar Jones, president of the Union Bank & Trust

Company, and administrator of John Schardt, deceased, and also to Theo. Cooley, agent of the Guarantee Company of North America, and delivering to Edgar Jones, president of the Union Bank & Trust Company, a copy of this bill, filed in this cause, this 4th day of June, 1894.

M. A. CONSADINE, *D. S.*

Demurrer of Union Bank and Trust Company.

Chancery Court, Davidson County.

MECHANICS' SAVINGS BANK AND TRUST COMPANY ET AL.
vs.
UNION BANK AND TRUST COMPANY ET AL.

Defendant, Union Bank and Trust Company, demurs to complainant's bill herein, and for causes of demurrer says:

1st. The bill is without equity on its face, as against this defendant.

2nd. Neither the originals, nor copies of the exhibits referred to in the bill are filed with it.

PITTS & MEEKS,
Solicitors for Defendant

Petition. Filed June 11, 1894.

In the Chancery Court of Davidson County, Tennessee.

MECHANICS' SAVINGS BANK AND TRUST COMPANY, Use of JAMES J. Pryor, Assignee,
vs.
UNION BANK AND TRUST COMPANY AND GUARANTEE COMPANY of North America.

Petition for removal of this cause to the United States circuit court for the middle district of Tennessee.

29 To the honorable chancery court of Davidson county, State of Tennessee:

Your petitioner, The Guarantee Company of North America, respectfully shows that it is one of the defendants in the above-entitled suit, and that the matter and amount in dispute in the above suit exceeds, exclusive of interest and costs, the sum or value of $2,000.00.

Your petitioner further shows that the said suit is of a civil nature, and that there is in said suit a controversy which is wholly between citizens of different States, and which can be fully determined as between them, to wit, a controversy between your petitioner which avers that it was at the time of the bringing of this suit, and still is a citizen of the province of Quebec in the Dominion of Canada, and the said complainants, The Mechanics' Savings Bank and Trust Company, and Jas. J. Pryor, its assignee, which, as your petitioner avers

were then and still are citizens of the State of Tennessee; that the said controversy is of the following nature, to wit, whether or not your petitioner which is in the business of issuing bonds of suretyship, is liable to the Mechanics' Savings Bank and Trust Company, or its assignee, James J. Pryor, on two certain bonds of suretyship issued by your petitioner to the said Mechanics' Savings Bank and Trust Company, guaranteeing the fidelity of John Schardt, as teller and cashier of said Mechanics' Savings Bank and Trust Company, and that your petitioner and the said complainants are both actually interested in said controversy.

Your petitioner avers that said Mechanics' Savings Bank and Trust Company was and is a corporation chartered and organized under the laws of the State of Tennessee; that its codefendant, The Union Bank and Trust Company, administrator of John Schardt, is a corporation chartered and organized under the laws of the State of Tennessee, and having its principal and only office in the city of Nashville, and said State, and that your petitioner, The Guarantee Company of North America, is a corporation chartered and organized under the laws of the Dominion of Canada, and that it has never been chartered under the laws of the State of Tennessee.

And your petitioner offers herewith a bond with good and sufficient security for its entering in said circuit court of the United States on or before the first day of the next session, a copy of the record in this suit, and for paying all costs that may be awarded by said circuit court, if the said court shall hold that this suit was wrongfully or improperly removed thereto.

And your petitioner prays this honorable court to proceed
30 no further herein, except to make the order or removal required by law, and to accept the said surety and bond, and to cause the record herein to be removed into said *surety and bond, and to cause the record herein to be removed into said* circuit court of the United States in and for the middle district of Tennessee.

And your petitioner will ever pray.

GRANBERRY & MARKS,
Solicitors for Petitioner.

STATE OF TENNESSEE, }
Davidson County. }

I, Albert D. Marks, being duly sworn, do say that I am a member of the firm of Granberry & Marks, the solicitors for the petitioner in the above-entitled cause, that I have read the foregoing petition and know the contents thereof, and that the statements and allegations therein contained are true, as I verily believe.

ALBERT D. MARKS.

Subscribed by the said Albert D. Marks, in my presence, and by him sworn to before me June 7, 1894.

[SEAL.] ALBERT M. COLYAR,
Notary Public.

Bond. Filed June 11, 1894.

Know all men by these presents that the undersigned, The Guarantee Company of North America, as principal, and Granberry & Marks, as sureties, are held and firmly bound unto The Mechanics' Savings Bank and Trust Company for the use of James J. Pryor, assignee, in the penal sum of $500.00 for the payment thereof well and truly to be made unto the said Mechanics' Savings Bank and Trust Company for the use of James J. Pryor, assignee, their heirs and assigns, we bind ourselves, our heirs, representatives and assigns jointly and severally, firmly by these presents.

Yet upon these conditions: The said Guarantee Company of North America having petitioned the chancery court of Davidson county, State of Tennessee, for the removal of a certain cause, therein pending wherein The Mechanics' Savings Bank and Trust Company for the use of James J. Pryor, assignee, is plaintiff, and The Union Bank and Trust Company, as administrator of John Schardt, and the undersigned, The Guarantee Company of North America, are defendants, to the circuit court of the United States for the middle district of Tennessee:

31 Now, if the said Guarantee Company of North America should enter into said circuit court of the United States on or before the first day of its next session, a copy of the record in said suit, and shall well and truly pay all costs that may be awarded by said circuit court of the United States, if said court shall hold that said suit was wrongfully or improperly removed thereto, then this obligation to be void, otherwise in full force and effect.

Witness our hands this 7th day of June, 1894.

GUARANTEE COMPANY OF NORTH AMERICA,
By Attorneys.
W. L. GRANBERRY, *Surety.*
ALBERT D. MARKS, *Surety.*

Decree of June 11, 1894.

MECHANICS' SAVINGS BANK AND TRUST COMPANY, to the Use of James J. Pryor, Assignee,
vs.
UNION BANK & TRUST COMPANY, Administrator of JOHN Schardt, and The Guarantee Company of North America.

In this cause commenced in this court, wherein The Mechanics' Savings Bank and Trust Company, and Jas. J. Pryor, were complainants, and The Guarantee Company of North America, a citizen of the province of Quebec, in the Dominion of Canada, was one of the defendants, it appearing that the said Guarantee Company of North America has duly filed in this court its petition for removal of this cause into the circuit court of the United States for the middle district of Tennessee, and filed with the said petition the bond with surety required by the act of Congress of March 3, 1875,

entitled "An act to determine the jurisdiction of the circuit courts of the United States, and to regulate the removal of causes from the State court, and for other purposes," and by the act of March 3, 1887, amendatory of the said last-named act.

It is therefore ordered that the clerk and master of this court forthwith certify to the said circuit court of the United States for the middle district of Tennessee a full and complete copy of the record and proceedings in this cause, and that this *cause* proceed no further in this cause.

32 STATE OF TENNESSEE, }
Davidson County. }

I, G. K. Whitworth, clerk and master of the chancery court at Nashville, do hereby certify that the foregoing transcript contains a full, true and perfect copy of all the papers and proceedings had in the cause wherein The Mechanics' Savings Bank and Trust Company, etc., is the complainant, and The Guarantee Company of North America, *et al.*, are defendants (except the exhibits to the original bill), as the same appears of record and on file in my office.

In testimony whereof, I have hereunto set my hand and affixed the official seal of said court at my office in the court-house in Nashville, this the 18th day of June, 1894, and 118th year of our American Independence.

[SEAL.] GEO. K. WHITWORTH,
Clerk and Master,
By J. R. WEST, *Deputy C. & M.*

Endorsed: U. S. circuit court. Filed July 11, 1894. H. M. Doak, clerk, by E. L. Doak, deputy clerk.

Deposition of Samuel D. F. McEwen, taken July 17, 1894, by consent of complainant and defendant, in the case of Mechanics' Savings Bank and Trust Co. *vs.* Guarantee Company of North America, now pending in the Federal court for the middle district of Tennessee.

Examined by complainant:

Q. 1. State your name, age, residence and occupation.

A. My name is Samuel D. F. McEwen; residence, Nashville, Tennessee; age, 44 years; insurance agent and book-keeper.

Q. 2. Please state whether at any time recently you were employed by the assignee of the Mechanics' Savings Bank and Trust Co. as book-keeper to go through the accounts of John Schardt, as teller and cashier of said bank, and whether you did so, and by whom were you assisted, and what you did, and the result thereof.

A. I was employed by the assignee of the Mechanics' Savings Bank and Trust Co., after he took charge of the books and assets of said bank, for the purpose of examining the books of said bank

during the term of office of John Schardt, as cashier and teller of said bank. I was assisted by Prof. R. W. Jennings, Allen B. Fisher, and part of the time by Wallace Norther. Mr. Fisher being
33 employed by Mrs. John Schardt, and Mr. Norther was employed to represent the Union Bank & Trust Co., the administrator of John Schardt, deceased, with will annexed. We continued our labors for several months, commencing the shortage account with date of September 12, 1890, and bringing it up to the 17th day of April, 1893, the day the bank assigned, with the following results, as shown in Exhibit "X" to the original bill which is made a part hereof.

Q. 3. Take up said Exhibit "X" and state for what amounts said Schardt was defaulter separately as teller and cashier, and the aggregate of the two with and without interest from the date of the defaults, and also with reference to the years and dates of his respective offices.

A. John Schardt, deceased, was made teller and collector of said bank on January 16, 1888, which is the date of his bond as sued on as such teller and collector, and continued to fill said office until he was made cashier of said bank, January 1, 1893. Therefore he filled the office of teller and collector under his original and renewal bonds from January 16, 1888, to January 1, 1893, and he filled the office of cashier from January 1, 1893, to the date of his death, on the 17th day of April, 1893.

As teller and collector from September 12, 1890, to January 1, 1893, he defaulted for the sum of	$78,819 24
Int.	5,275 39
	$84,094 63

Subdivided as follows:

From Sept. 1, 1890, to Jan. 16, 1891	$5,879 34
Int.	890 04
	$6,769 38
From Jan. 16, 1891, to Jan. 1, 1892	$22,290 00
Int.	2,299 08
	$24,589 08
From Jan. 1, 1892, to Jan. 1, 1893	$50,649 90
Int.	2,086 27
	$52,736 17

As cashier:

From Jan. 16, 1893, to date of death	$22,964 17
Int.	164 52
	$23,128 69

34 Q. 4. Please state what was the character of these defaults and of what did they consist as respects detention.

A. They were extractions from the funds of the bank made by Schardt, as were evidenced by the books kept by him, and covered on the books kept by him from detection by false additions, and by failure to enter notes and moneys collected by him on books, and also failure to give proper credit to depositors of correct amounts of their deposits, also of failure to credit on the books of the bank interest on notes collected by him belonging to the bank.

Q. 5. Please state whether these abstractions or embezzlements were easily or readily detectable from the books of the bank and what had to be done to detect the falsity of the books.

A. The errors could have been easily detected by an expert bookkeeper. His falsifying of the books was done in the main in false additions on his cash book, and whenever this was done he nearly always falsified the general account of "individual depositors" on his general ledger, to correspond with the error made on the cash book. A few of his false additions on his cash book were covered up by falsifying one or more of his other accounts on his general ledger. The amount shown as due individual depositors by the account on the general ledger, was far less than that actually shown to be due by the pass books of said depositors.

Q. 6. Did you know or learn to know the handwriting and figures of Schardt, if so, was it in his handwriting and figures, which showed that it was Schardt who tampered with and falsified the books?

A. I had seen Mr. Schardt's figures before I commenced my work in the bank, and learned to know them well while there and all of the false additions were made in his figures, and also the falsifying of the general accounts were in his figures.

Q. 7. How long were the book-keeper and you engaged in ascertaining these abstractions?

A. Several months.

Q. 8. What is the character of the gentleman who was associated with you in this matter, as book-keeper?

A. They stand high in the community as expert accountants.

Q. 9. In order to ascertain the facts of embezzlements of the funds of the bank, was it necessary to refer to various and different books?

A. It was.

35 Q. 10. Please state if you have called in all pass books and examined the same, and whether the entries in said pass books during the time Schardt was teller were in his handwriting.

A. When he failed to give proper credits to depositors on the individual ledger, the entries on the pass books were in his figures.

Q. 11. Please state if there were entries in pass books for which no ticket could be found.

A. Yes, there were.

Q. 12. Please state whether the amounts as stated above by you were taken from the funds of the bank.

A. These amounts mentioned were abstracted by John Schardt, I presume they belonged to the bank.

Q. 13. Please state whether Schardt is dead, if so, when did he die?

A. John Schardt is dead. He died in April, 1893.

Q. 14. Please state what books the cashier or teller of State banks keep and make entries in.

A. I don't know what books they are required to keep, but Mr. Schardt kept the cash book and made out the daily balance book in the Mechanics' Savings Bank & Trust Company, both while he was teller and collector and cashier of said bank.

Cross-examination:

Q. 1. When were you first employed to examine into the affairs of the bank, by whom and what instructions were given you?

A. I was employed by Mr. Eatherly, the president, April 15th, 1893, went on the morning of that day between 8 and 8.30 o'clock. I was told by the president that the books had not been examined (by an expert book-keeper) for some time although they had changed offices once or twice, and while they did not believe there was anything wrong, yet they wished to have the books verified by a disinterested man.

Q. 2. How long were you engaged in examining the affairs of the bank?

A. Several months after the assignment.

Q. 3. Are you now able to speak with accuracy with reference to the books kept by the bank; that is, its methods of keeping its books from 1890 to the time it closed?

A. I am.

Q. 4. Please explain the methods of keeping the books, and what books were kept.

A. The principal books kept by the bank were, individual ledger, which showed in detail the deposit account of each individual
36 depositor. This book was kept by a clerk who had no other duties and he was known as individual book-keeper, and the book kept by him was called the individual ledger. The teller, up to the time Schardt was elected cashier, kept three books. The first was a general ledger which is a book in which an account is opened of every account the bank has except the individual depositors. The accounts of demand loans, discounts, bonds and stocks and such like accounts are kept in this book; it also has an account showing in totals the deposits made and checked out each day by individual depositors. This book was kept by Schardt from behind 1890 to the time the bank closed. Then there is another book, called the cash book, which shows the same thing, as the general ledger, except that instead of putting the business of each day under various accounts, they are grouped together on one page in the cash book and shows at a glance the entire business transacted by the bank during the day. For example, take any day, the cash book will begin with the amount of cash on hand, and will be debited

with all receipts of that day, showing from what source derived, and will be credited with all disbursements for the day, showing in detail on what account made. This cash book was also kept by Schardt from behind 1890 to the time the bank closed, and a sample page of the book is herewith filed as Exhibit No. 1, to this deposition, which is an exact copy of the business of the bank for January 31st, 1893. There was another book, called the daily balance book, and showed a summary of each account from the general ledger. At the close of each day's business, it showed the exact amount of discounts, demand loans, bills receivable, bonds and stocks, cash on hand and individual deposits, and I herewith file as Exhibits 2 and 3 two sample pages from the said book which are exact copies of the pages from the book for January 30th and 31st, 1893. This book was kept by John Schardt from behind 1890 to April 14th, 1893. These four books were the principal books of the bank and they were all kept by John Schardt, except the individual ledger, and with that he had nothing to do.

Q. 5. When you went into the bank to examine it what method did you pursue, and how soon did you discover that there was a shortage?

A. The first thing that aroused my suspicion was when I looked at the cash book, I saw that the cash balance was on the wrong side of the cash book. What I mean by the cash balance being on the wrong side is, that instead of there appearing a cash balance of money on hand, it appeared that they lacked $466.00 of having anything, and I thereupon asked the teller, Mr. Boensch, if he had any money on hand and he opened the drawer and exhibited to me a considerable amount of money. I then called for the daily balance book, and saw from it they owed individual depositors less than $18,000. I then turned to the individual ledgers, and by 4 o'clock in the afternoon I had discovered that from their individual ledger from "A" to "L" they owed in the neighborhood of $55,000, and I then thought there was something radically wrong, and so reported to the president.

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Q. 6. What do you mean by individual ledger from from "A" to "L"?

A. I mean all individual depositors whose names begin with either letter from A to L, inclusive, have their accounts entered on that book, and all other individual depositors are entered on another book from M to Z.

Q. 7. Do I understand you to say that John Schardt performed the same duties with reference to keeping the books of the bank after he was elected cashier that he did while teller?

A. He did, so far as the books above referred to are concerned.

Q. 8. Why did you begin only at September, 1890, to check up the books?

A. Because that was the date up to which Prof. Jennings had made an examination, and all balances were correct up to that time and that was the starting point.

Q. 9. In question No. 5 of the direct examination you are asked to state what had to be done in order to detect the falsity of the

books, and you do not appear to have answered that part of the question. Will you now do so?

A. If they had called for a detailed statement from the individual ledger and had compared that with the daily balance they would have seen something was wrong, just as I discovered it when I went in to examine the bank's books.

Q. 10. What do you mean by calling for a statement from the individual ledger?

A. I mean, called for each individual depositor's account and his balance.

Q. 11. Suppose they had asked the individual book-keeper for a trial balance from his book, by which I mean the total amount as shown on his book to be due individual depositors by the bank, would this not have at once shown the falsity of Schardt's books?

A. It would have shown that the amount due to their in-
38 dividual depositors on the individual ledger was far in excess of the amount shown to be due individual depositors upon the books kept by Schardt.

Q. 12. In examining the accounts of Schardt as teller, what method was there by which his accounts could have been verified?

A. They could upon any day at close of business, have taken the daily balance book, showing a record of the condition of the bank at that time and counted the notes on hand, bills receivable, bonds and stocks and cash, and could then have verified the amount appearing to be upon deposit in other banks to the credit of complainant bank, and this would have only left to be verified the amount shown to be due depositors, and the way to verify this would have been to have taken from the individual ledger a trial balance which would have shown the amount due depositors by the bank, and if this had agreed with the amount appearing upon the daily balance book to be due depositors, the officials of the bank would have verified his accounts as closely as would be possible.

Q. 13. How long would it have taken at any particular time to have secured from the individual ledger a trial balance of the amount due depositors?

A. It ought not to, in a bank of that size, take over twelve hours.

Q. 14. What proportion of the shortage was covered by misstating the amount due depositors upon the books kept by Schardt?

A. Nearly all of it.

Q. 15. Please furnish statement marked Exhibit 4, showing in detail the amount embezzled in each particular year, and each method.

A. (See Exhibit "4" filed herewith.)

Q. 16. Did the fact that Schardt was permitted to keep the general ledger and act as general book-keeper in the bank greatly increase his facilities for embezzling the funds of the bank?

A. Certainly it did.

Q. 17. You speak of there being two individual ledgers. When did they begin to have two and were they kept by one person?

A. I do not know when they commenced to have two, but they were kept by one man.

Q. 18. In answer to question No. 12, you have explained one way in which the accounts of Schardt could have been verified by the officers of the bank. Please state in what other ways, if any, such verification could have been made.

A. I do not know of any other way.

39 Q. 19. What experience have you had in book-keeping and state whether or not you consider yourself an expert on that line of work, and are you so considered by others?

A. I have kept books for twenty-five years and I consider myself an expert, and am so considered by others.

Q. 20. Would it have been possible for Schardt to have embezzled funds of the bank to any extent without detection, if he had not been permitted to keep the general ledger?

A. It would not have been possible for him to embezzle the funds in the manner he did, if he had not been permitted to keep the general ledger and balance book.

Q. 21. Did you discover in the bank a trial-balance book? I mean a book in which a trial balance from the individual ledgers were kept?

A. I saw a book of that character when I went in there, but it was incomplete, the balances not entered up and I paid no attention to it, and I do not know for what years they were taken off.

Q. 22. Are you familiar with the method of keeping books in State banking institutions such as this one?

A. Yes, I was for three years and a half in one of these banks and I think I am familiar with them.

Q. 23. If I understand you correctly an overwhelming part of the defalcations of Schardt was caused by misstatements on the books kept by him, as to amounts due individual depositors?

A. Yes, sir.

Q. 24. Please state how Schardt manipulated the books of the bank kept by him.

A. His shortage was chiefly by abstractions from the cash, and these shortages were covered up by false additions on the cash book, and in order to make the daily balance books agree, which is Exhibits 2 and 3 to my deposition, he misstated on the daily balance book the amount due individual depositors by the exact amount he had abstracted on that day.

Q. 25. Was the amount shown to be due individual depositors, the only account on his books which was falsified prior to January 1st, 1893?

A. That was the only one. There may have been other errors, which would run up to something like $500, but not enough to amount to anything.

Q. 26. Then as I understand you, beginning with the first shortage and continuing on down through the various times in which he was continuing to abstract money, he continued to understate the amount due individual depositors by the amounts he had abstracted at various times?

40 A. Yes, sir.

Q. 27. Then at any time the amount he had abstracted

added to the amount shown on his books to be due individual depositors would make the amount actually due individual depositors?

A. Yes, sir; in the main it would.

Q. 28. Referring to Exhibit "I" to your deposition, which is the cash book, please state whether the various accounts there shown were correctly entered upon that book during the time Schardt kept the same.

A. So far as I know, they were properly entered upon that book.

Q. 29. Please state where the error was with reference to the cash book.

A. In posting from the cash book to the general ledger of this page on the cash book the amounts on the cash book were properly and correctly carried to the general ledger, but in taking the balances of the accounts on the general ledger, in order to make up his daily balance, he made an error in his addition in the individual depositors' accounts of the amount he had abstracted that day.

Q. 30. Then I understand there was no error or falsification of the cash book, except that whenever he stole an amount in one day, in adding up his cash book that day he would make an error in addition for the amount he had stolen?

A. Yes, sir.

Q. 31. Then as I understand you, the various items on Exhibit "X" in which you state that the shortage is in adding cash book, do you mean to be understood as saying that on each of those dates, he made an error in addition on this cash book?

A. Yes, sir.

Q. 32. Were there any falsifications of the books to misstate the amounts of discounts and demand loans owned by the bank?

A. No, sir; there were no false entries.

Q. 33. Then if no notes were abstracted from the bank the amounts of discounts and demand loans would at all times have agreed with the amount shown to be on hand on the books kept by Schardt?

A. It would with the exception of clerical errors, which were liable to occur at any time.

Q. 34. In answers to your questions Nos. 27, 29 and 30 of your cross-examination, do you mean to include all the shortage of Schardt?

41 A. No, I do not intend to include that part of the shortage occurring by Schardt having collected notes and not accounting for them on the books of the bank, and some few other items as fully appears upon Exhibit "X."

Q. 35. Please explain the method pursued by you in order to ascertain that Schardt had collected notes and not accounted for the proceeds.

A. The bank kept a book in which each note owned by the bank was entered and numbered, when the bank received it. And on this book was shown the date of the note, the makers, the collaterals, the date of maturity and the date it was paid. I began in September, 1890, at the time Prof. Jennings' other examination ended, and I entered upon a new book each note which appeared

by the bank's books to be owned by the bank of that date. I then marked on this book the date of payment, opposite each note owned by the bank, from that time down to the date the bank closed. I then went over the list again and checked off each note owned by the bank, and which was on hand at its failure.

This left certain notes on my book unpaid, and not on hand. I then went to the makers of the notes and found that they had been paid to Schardt and he had not accounted for same.

Q. 36. Could this information have been ascertained at any time after these notes were abstracted or paid, and unaccounted for as well as when you ascertained these facts?

A. Yes, sir; by such an examination as I made.

Q. 37. Then, if I understand you correctly, at any time after Schardt had collected a note and appropriated the money to his own use, if the amount of notes on hand had been counted, would they have agreed with the amount on his books shown to be on hand, less the amount of the notes he had abstracted?

A. Yes, sir.

Q. 38. Do I understand you to mean that at all times the amount of discounts and demand loans shown on the books kept by Schardt to be due the bank was correct?

A. Yes, sir, barring clerical errors.

Q. 39. Did you verify the entries on the books kept by Schardt with reference to amount of discount and demand loans to ascertain whether or not the book was correct in this regard?

A. Yes, sir, the book I made up agreed exactly with the books kept by Schardt.

Q. 40. Who collected the discount and demand loans of the bank?

A. The teller.

42 Q. 41. Who assisted you in making up this book and arriving at the amount of notes abstracted by Schardt?

A. Professor R. W. Jennings.

Q. 42. Was there any omission or error in the individual ledgers, or did they correctly show the deposits of each depositor up to January 1st, 1893?

A. The posting on the individual ledger in the main were correct. There may have been a few errors, but not enough to amount to anything.

Q. 43. Please give a statement showing the amount of the discrepancy between the individual ledgers and the general ledgers or daily balance book on January 16th, 1891, and January 1st, 1892, and 1893; also the difference between the notes (demand loans and discounts) actually on hand in the bank, and the amount shown to be on hand by the daily balance book on the same days.

A. The individual ledgers, if a trial balance had been taken from them, would have shown on January 16, 1891, that there was due individual depositors $2,098.00 more than was shown to be due them by the daily balance book on the same date. And on January 1, 1892, there was a difference in the same way of $19,600.00. And on January 1, 1893, there was a difference in the same way of $69,700.00.

On January 16, 1891, there was on hand thirty-seven hundred and sixty-five and $\frac{44}{100}$ dollars ($3,765.44), in notes (represented in discounts on the daily balance book) less than is shown to have been on hand for the daily balance book of the same date.

There was no change in this amount on January 1, 1892, and on January 1, 1893, the difference was four thousand and fifteen dollars and $\frac{44}{100}$.

S. D. F. McEWEN.

43 The following is Exhibit No. 1 to McEwin's deposition, viz:

Copy of page 354, Cash Book, Mechanics' Savings Bank & Trust Co.

NASHVILLE, TENNESSEE, TUESDAY, *January* 31, 1893.

DR.

Balance				8,666 48
Discounts:				
11806	Jno. C. Burch	800 00		
11621	G. M. Neeley	400 00		
Bal. 11573	Osborn & Tanner	5,936 90		
			7,136 90	
Commercial nat'l bank:				
	Howell, cas'r	972 56		
	Harrick	1,750 35		
	Grantland	3,357 01		
	Porterfield, cash'r	2,608 64		
	Exct	5,000 00		
			13,688 56	
United States nat'l bank:				
	Err. in telegram of 23 inst. of dep. W. W. Price		$20 00	
3974	Hubbard, Price & Co	3,992 00		
5	Eddy & Jones	15 70		
			4,007 70	
Individual deposits:				
	Deposits		6,674 89	
				31,528 05
				40,194 53

Copy Cash Book, page 355, Mechanics' Savings Bank & Trust Co.

NASHVILLE, TENN., TUESDAY, *January* 31, 1893.

CR.

Discounts		400		
11922	G. M. Neeley	100		
11923	Nellie Boyd	300		
4	J. P. Osborn, W. P. Tanner	5,636 90		
5	J. P. Osborn, W. P. Tanner			
				6,436 90
Expenses:				
	Jno. Schardt	166 66		
	L. T. Baxter	25		
	Frank Bomach	100		
	Lem McDowell	41 66		
	Lem. McKeand	7 50		
	Van Nealy	7 50		
	Hodge, watchman	4 00		
			352 32	
	Stamps, $6.00; M. Ewan, 80c		6 80	
				359 12

Commercial nat'l bank, deposit:		
Deposit	{ 4,833 46 { 2,644 75	7,478 21
United States nat'l bank:		
No. 106,409 Nat'l Bank of Rep. by Com'l nat'l bank		5,000 00
Individual deposits		10,264 09
Balance		8,656 21
		40,194 53

44 EXHIBIT "2."

JANUARY 30, '93.

NAME.	DRS.	CRS.
Discounts	98,338 27	
Demand loans	85,942 93	
Bills receivable	8,334 46	
Bonds and stocks	4,271 00	
Judgments		
Furniture and fixtures	1,906 26	
Expense	81 80	
Interest paid on deposits	602 80	
Taxes and license	1,050 00	
Cash	8,666 48	
Commercial national bank	15,125 89	
United States national bank	3,358 30	
H. D. Cooper	1,376 83	
J. M. Head	933 60	
G. P. Rose	6,305 78	
Sykes, Chas., ag't	699 87	
Capital stock	.....	$50,000 00
Surplus	.....	2,000 00
Undivided profits	.....	23,116 63
Profit and loss		
Commissions received	.....	146 66
Interest and exchange	.....	533 22
Herzfeld & Co.	8 17	
Theo. W. Myers & Co.—long	.....	6,231 61
Theo. W. Myers & Co.—short		
Individual deposits	.....	140,291 57
Certificate of deposit	.....	14,682 75
Cashier's checks		
Certified checks		
Bills payable		
	237,002 44	237,002 44

45 EXHIBIT "3."

JANUARY 30, '93.

NAME.	DRS.	CRS.
Discounts	97,638 27	
Demand loans	85,942 93	
Bills receivable	8,334 46	
Bonds and stocks	4,271 00	
Judgments		
Furniture and fixtures	1,906 26	
Expense	440 92	
Interest paid on deposits	602 80	
Taxes and license	1,050 00	
Cash	8,656 21	
Commercial national bank	8,915 54	
United States national bank	4,330 60	
H. D. Cooper	1,376 83	
J. M. Head	933 60	
G. P. Rose	6,305 78	
Sykes, Chas., ag't	699 87	
Capital stock		$50,000 00
Surplus		2,000 00
Undivided profits		23,116 63
Profit and loss		
Commissions received		146 66
Interest and exchange		533 22
Herzfeld & Co.	8 17	
Theo. W. Myers & Co.—long		6,231 61
Theo. W. Myers & Co.—short		
Individual deposits		134,702 37
Certificates of deposits		14,682 75
Cashier's checks		
Certified checks		
Bills payable		
	$231,413 24	$231,413 24

46 EXHIBIT "4."

Shortage from Sept. 12, '90, to Jan. 16, '91		5,879 34
Interest		890 04
		6,769 38
Error adding deposit book	101 00	
Error adding check book	10 00	
Errors adding notes discounted	5 00	
Collecting notes and not crediting same	3,765 44	
	3,881 44	
Less credits	100 00	
	3,781 34	

Manipulation of ind. depositors to cover up errors in addition on cash book	2,098 00	
Interest	890 04	
		6,769 38
Shortage from Jan. 16, '91, to Jan. 1, '92		22,290 00
Interest		2,299 08
		24,589 08
Error adding Com'l b'nk	330 00	
Error transferring checks to cash book	1,051 00	
Error adding check book	1,111 00	
Error adding deposit book	2,600 00	
	5,092 00	
Less credits	304 00	
	4,788 00	
Manipulation of ind. dep.	17,502 00	
Interest	2,299 08	
		24,589 08
Shortage from Jan. 1, '92, to Jan. 1, '93		50,649 90
Interest		2,086 27
		52,736 17
Error—failure to credit dep.	$163 00	
Error—adding dep. book	173 00	
	665 50	
Less credits	115 60	
	549 90	
47 Interest	2,086 27	
Manipulating ind. dep.	50,100 00	
		52,736 17
Shortage from Jan. 1, '93, to Apr. 17, 93		22,964 17
Interest		164 52
		23,128 69
Failure to cr. notes collected	2,567 80	
Failure to cr. demand loans	615 00	
Adding notes discounted	50 00	
Adding deposit book	1,362 37	
Failure to enter deposits	1,359 62	
Overdrafts allowed and not authorized	5,992 35	
	11,947 14	
Less credits	24 22	
	11,922 92	

Manipulation of ind. dep.....	11,041 25	
Interest.....	164 52	
		$23,128 69

Deposition of R. W. Jennings, Taken by Complainant.

Q. 1. State your name, age, residence, and occupation.

A. R. W. Jennings; age, 56; Nashville; a business educator.

Q. 2. State if at any time you were employed by Jas. J. Prior, assignee of the complainant company, and if so for what purpose, by whom you were assisted and how much time was required.

A. I was employed by Jas. J. Prior, assignee, to examine the books and papers of the Mechanics' Savings Bank & Trust Co. to ascertain the condition of the accounts of Jno. Schardt, as teller and cashier of said bank. In this I was assisted by S. D. F. McEwen, W. W. Norther and A. B. Fisher. I was several months engaged in this.

Q. 3. Please state what was the result as discovered from the books of the bank.

A. I examined the books from September 9, 1890, to April, 1893, finding John Schardt's shortage during that time as teller and cashier, including interest, to be $107,182.12. Of this amount the following was as teller:

48	From September 12, '90, to Jan. 16, '91.....	$5,879 34	
	Int.....	890 04	
			$6,769 38
	From Jan. 16, '91, to Jan. 1, '92.....	22,290 00	
	Int.....	2,299 08	
			24,589 08
	From Jan. 1, '92, to Jan. 1, '93.....	50,649 90	
		2,086 27	
			52,736 17

And as cashier:

From Jan. 1, '93, to April 17, '93.....	22,964 17	
Int.....	164 52	
		23,128 69

Q. 4. From whom had the money been taken or abstracted?

A. From complainant bank.

Q. 5. Was the fact shown by books kept by Schardt, or which was under his care or keeping?

A. Yes.

Q. 6. Was it shown to be money taken or other valuables?

A. As money taken.

Q. 7. How was Schardt shown to be connected with the embezzlement?

A. The manipulations on the books were all shown to be in his handwriting.

Q. 8. Were you familiar with his handwriting?

A. I was for several years previous to his defalcation.

Q. 9. Have you read the deposition of S. D. F. McEwen? If so, state whether you concur in the statements made there, and especially in the exhibits thereto.

A. I have, and fully concur in said exhibits. They were the results of our examination.

Q. 10. Please state what were the kind and character of manipulations resorted to by Schardt, and its evident purpose.

A. False additions and his failure to enter properly moneys received for notes collected by him and moneys deposited in bank by some of its depositors, as shown by his handwriting in their pass books.

Q. 11. Please state whether the embezzlements could have
49 been detected and brought to light except by an expert book-keeper.

A. No person not an expert book-keeper could have found many of these manipulations, but it would not have been difficult for any one who could add columns to have seen some of these false additions, which would have resulted in causing suspicion that some wrong was intended.

Q. 12. What was the matter with the Durr account as cashier?

A. As I now remember, the main trouble was that Durr was retaining a part of the commissions earned by the bank and appropriating same to his own use, instead of turning over the whole amount to the bank.

Cross-examination:

Q. 1. In direct question No. 9 you are asked whether or not you adopt the answers of S. D. F. McEwen. Please state whether or not you mean to be understood as adopting also his cross-examination.

A. I do, with the following exceptions: In answer to cross-question No. 8, it is stated by him that we begun our examination in September, '90, because I had previously examined the books up to that day, and found all balances were correct up to that time. This is a mistake; I never examined Schardt's books, but I did examine about that time certain aspects of the bank's affairs with respect to the cashier, Mr. Durr. I don't remember ever having seen a trial-balance book from the individual ledger in the bank. With these exceptions, I adopt the cross-examination.

Q. 2. Did you find the books of the bank with reference to the cashier to be correct at the time you examined them in September, '90?

A. I did not find any of the books of the bank false, for the reason the cashier did not keep the books, but I did not find the accounts of the cashier correct.

Q. 3. Then you do not know whether the books of the bank, so far as Schardt is concerned, back of September, '90, are correct or not, do you?

A. I do not.

Q. 4. Would any page in the daily balance book, which is Exhibit- 2 and 3 to McEwen's deposition, show each day the exact condition of the bank, its assets and liabilities, and what they consisted of?

A. It ought to show that fact if the books were not falsified.

Q. 5. In what respect did you find this book to be incor-
50 rect?

A. Particularly in the amount as shown due individual depositors. There were other errors in other accounts, but not to any material extent.

Q. 6. In examining the books kept by Schardt, whether the same was done by an expert, bank officer or committee, would they or not be compelled to start as a basis with Exhibit- 2 and 3 to the deposition of McEwen?

A. They would necessarily have to start with some showing which purported to be correct, and then see that said showing came correctly from the books.

Q. 7. Did the books of the bank show at the end of each day's business the amounts of notes discounted on hand and the amount of the demand loans?

A. It ought to show it.

Q. 8. What way could the amounts shown to be due individual depositors on the general ledger kept by Schardt be verified?

A. By examining the individual ledger itself and ascertaining whether or not the aggregate due depositors by that ledger corresponded with the aggregate as shown on the general ledger.

Q. 9. How long would it take the book-keeper having the individual ledgers to foot up the total amount shown by his books to be due individual depositors in this bank?

A. Of course it depends upon the rapidity of the work of the book-keeper. I should think twenty-four or thirty-six hours would be sufficient for an average book-keeper to do that work.

Q. 10. Are you familiar with the system of bank examinations generally in use in banks such as this?

A. I am.

Q. 11. State whether or not it is customary for banks like this at frequent intervals to take a trial balance from the individual ledgers showing the amount due depositors.

A. It is.

R. W. JENNINGS.

Deposition of J. M. Eatherly, Taken by Judge E. H. East on Behalf of the Complainant.

Q. 1. Please state, Mr. Eatherly, your age.

A. I am 66 years old.

Q. 2. State what has been your relations with the Mechanics' Savings Bank & Trust Company for several years past.

51 A. I was a director in the bank from its organization until its assignment.

Q. 3. Did you fill any other position?

A. For a considerable length of time I was on the finance committee, and for about twenty days I was president of the bank.

Q. 4. Please state what twenty days you were president.

A. I was elected on the 28th of March, 1893, and the bank assigned on the 17th of April.

Q. 5. Were you also a stockholder in the bank?

A. Yes, sir.

Q. 6. To what extent?

A. I had originally $2,000 worth of stock in it. When the bank closed I had only $1,000.

Q. 7. Were all the directors stockholders in the bank?

A. Yes, sir.

Q. 8. During what time were you on the finance committee?

A. I was for several years and prior to my election as president.

Q. 9. State whether it was a State or national bank.

A. It was a State bank.

Q. 10. Was it a State bank simply of deposit and discount?

A. Yes, sir.

Q. 11. What was its capital stock?

A. $50,000.

Q. 12. Was it fully equipped with all officers?

A. Yes, sir.

Q. 13. How many men constituted the directory?

A. My recollection is about seventeen.

Q. 14. What committees did you have?

A. We did not have any committees except the finance committee, except occasional special committees for certain purposes.

Q. 15. Were you intimately connected with the bank during the time John Schardt was cashier?

A. Yes, sir.

Q. 16. Also while he was teller?

A. Yes, sir.

Q. 17. Were you continually and daily at the bank?

A. Nearly every day.

Q. 18. State the habits of the finance committee with respect to going over the accounts and transactions of the executive officers—when they did it, how they did it.

A. The finance committee made quarterly examinations of the bank's condition—that is every three months. Mr. Schardt
52 would make out a list of the assets of the bank, and that list was taken charge of generally by myself and a portion of the finance committee—we hardly ever got them all three together—generally about three of them acted. We went to where the securities were kept and took them to the directors' room, or rear part of the bank and compared them with the amounts given on the list to see whether they corresponded. We examined the collaterals or evidences of them to see if they were there. We counted the cash on hand, and had generally a certificate from the banks where we

deposited as to the amounts in those. We then compared the footings with the amount as shown on the daily balance sheet or balance book to see whether they agreed with them. We found no discrepancies except in the cash on hand in a few instances. Generally there was a discrepancy of a few dollars between the money on hand and the amount shown by the daily balance sheet. Sometimes it was a deficit and sometimes a gain, but generally a deficit.

Q. 19. Was this custom of examination habitual and continuous?

A. Yes, sir.

Q. 20. Had it been or not the habit of the bank to do these same things for many years during its existence?

A. Yes, sir; it had been the custom. In addition to this semi-annual reports were submitted to the directors by the cashier.

Q. 21. Was it the habit of the president or some one of the directory to be present in the bank at all times?

A. Yes, sir; it was rarely the case that there were not some of them there.

Q. 22. Did you see John Schardt just before his death, and if so how long before, and where did you see him, and under what circumstances?

A. I saw him on Saturday evening the 15th day of April, 1893, and he died on the 17th of April, 1893, and at the time I saw him he was very ill.

Q. 23. Who was with you at this interview?

A. I had two interviews with him on Saturday evening. Mr. J. B. Richardson was with me on the first interview.

Q. 24. Who is Mr. Richardson?

A. One of the directors.

Q. 25. Where did these interviews take place?

A. At Mr. Schardt's house in Nashville.

Q. 26. Was he or not in bed at the time?

A. He was.

Q. 27. Under a doctor?

53 A. I suppose he was.

Q. 28. What was the purpose of this interview?

A. We went there for the purpose of having an explanation as to a discrepancy we had found between the individual ledger, as far as had been examined, and the daily balance-sheet.

Q. 29. Now state all that was said on either side as you best remember it?

A. I think we were ushered into the sick room by Mrs. Schardt and she retired and left Mr. Richardson and myself with Mr. Schardt, and after asking him how he was, etc., I told him that we had come out for the purpose of getting an explanation as to the discrepancies mentioned above. I told him we had found errors in his books. He said, "Mr. Eatherly, my books are correct." I told him that I did not see how he could reconcile the two things that we had found the daily balance-sheet showing something less than $18,000 du depositors, while the individual ledger as far as had been examine by Mr. McEwan and Mr. Richardson, showed about $55,000 du

depositors. He reiterated that his books were absolutely correct. I said, "John, I cannot understand it that way." I was satisfied there was an error somewhere. I asked Mr. Richardson if he wanted to ask him any question. He was silent a moment or two and said, "I don't know that I do." He then turned to Mr. Schardt and said: "John, I am bound to say to you that you are a defaulter." Mr. Schardt broke out into a cry, putting his hands over his face and said: "My God! it is true—too true." I said: "John, compose yourself; we have come here for facts and want facts." I then asked him how much was his default and he said about $40,000. I told him if the other individual ledger showed the same proportion of discrepancy that this one did that he was a defaulter to a much larger amount—I would say to not less than $60,000 or $70,000. He said, "Mr. Eatherly, you are mistaken. It cannot be that much." I then asked him how he had lost it, and he said, "Speculating in New York, and you can get it all back." He said, "you," meaning the bank. I said, "No, John, we can do no such thing; the laws of New York legalize this sort of trading, and we cannot recover it in that way." I asked him who he had traded with there, and he told me three firms, but I remember only one of them—Hubbard, Price & Co. After I told him we could not get it from them he said, "I can secure it myself." One of us asked him how he could secure it. He said he had a lot of life insurance and some real estate and some notes. I asked him what real estate he
54 had. He said he had a lot on McNairy street and a house and lot on Pine street, and he was willing to convey everything he had to secure this debt. I told him to remember that he had a wife and child to support. He said his wife would join him in anything he did. We then asked him as to the amount of his insurance, and he said he had $80,000 insurance. He said he was willing to transfer those policies to the bank. This was agreed upon by him and myself and Mr. Richardson. We then made preparations to leave, and I told him that I would send Mr. M. T. Bryan, the attorney for the bank, out after we went back to the bank. That ended the interview so far as I recollect it.

Q. 30. What was his condition mentally?

A. His mind seemed as clear as it ever was.

Q. 31. Did you go back with Mr. Bryan at a later hour in the day?

A. Mr. Bryan said he did not know where Mr. Schardt lived and asked me to go with him; I did so and was met at the door by John Schardt's brother, Augustus, who took us into the sick room, and we told Mr. Schardt that we had come out to fix the transfer up. It was mentioned that it would be necessary to have a notary public and two or three names were mentioned, and I told Mr. Gus Schardt that if he would go for Mr. Waddey that I was satisfied that he would come. He went for Mr. Waddy and brought him there and in the meantime Mr. Bryan was drawing up the transfer of the insurance policies, the real estate and some notes of hand, and some stock—I think possibly in a patent medicine company—and I think he transferred his Bank of Commerce stock. After

this transfer was made Mr. Schardt got Mr. Bryan to write his will confirming to the fullest extent the transfer. Mr. Gus Schardt got out all of the papers and seemed to be aware of his brother's intention.

Q. 32. Did he execute these assignments?

A. Yes, sir.

Q. 33. What has become of those policies?

A. Sixty thousand dollars of them are in suit; twenty thousand dollars has been paid to the assignee.

Q. 34. What became of the notes?

A. I understand they are in suit also.

Q. 35. What became of the deposit in the Bank of Commerce?

A. It is an insolvent institution.

Q. 36. The real estate?

A. It was conveyed to Mr. Richardson as trustee for the bank and that trust has not been wound up.

55 Q. 37. What steps has the bank taken to ascertain the amount of Mr. Schardt's default?

A. They employed expert book-keepers, together with the administrator, and you might say his family, who went through the books and ascertained the shortage.

Q. 38. What is the amount of default as reported?

A. About $103,000.

Q. 39. What effect has that had upon the bank?

A. It has caused it to be insolvent.

Cross-examination by W. L. GRANBERY, for defendant:

Q. 40. Were you ever connected with a bank institution before or since this one?

A. Only as a stockholder.

Q. 41. Were you present at each examination of the accounts of Schardt from January, '91, to the time the bank closed?

A. I think I was generally present.

Q. 42. But you are not able to state that you were present at each of them?

A. If there was any examination made when I was not there I don't know it.

Q. 43. How many members of the board of directors constituted the finance committee and were they all members of the board from 1890 until the time the bank closed?

A. The finance committee generally consisted of five members, the president being an *ex officio* member also. As far as I remember they were all directors.

Q. 44. You have stated that you generally had a statement from other banks where you kept deposits, in making these examinations do you mean to say that there were examinatians had in which such statements were not procured from the other banks?

A. That is the only way we had to get at the money on hand and I have no recollection of any examinations being made in the absence of those statements.

Q. 45. Did you or not say that Schardt made out the list of assets belonging to the bank for the examination of the committee both during the time he was teller and during the time he was cashier?

A. Yes, sir.

Q. 46. Please examine the exhibits to the deposition of S. D. F. McEwen and state which one of the exhibits is taken from the book which you compared or referred to in making your examinations.

A. Exhibit 2 is the book we examined and compared.

56 Q. 47. Who collected the demand loans and discounts for the bank?

A. It was the teller's duty and he did it.

Q. 48. How did you examine the amount of discounts and demand loans owned by the bank?

A. We took them one by one and examined them.

Q. 49. Did you compare the total with the book from which Exhibit 2 to McEwen's deposition is taken, or did you compare the amount of notes examined with the list furnished you by Schardt?

A. The manner in which we did that was this: One member of the examining board would take the evidences of debt to the bank and call out the amount; another member of the committee would check off on the list furnished by Schardt.

Q. 50. Were the totals added up?

A. Always. That I made my special duty.

Q. 51. Did the totals agree with the amount as shown to be due the bank on the list furnished by Schardt?

A. Yes, sir, with the exception of slight errors as before explained, in the cash.

Q. 52. Was the total amount of discounts and demand loans compared with the amount shown on the book from which Exhibit 2 is taken?

A. Yes, sir.

Q. 53. Then, if the experts who have testified in this case have stated that Schardt abstracted something like $4,000 of notes or the proceeds thereof, in the year 1890, and also that his books from which Exhibit 2 to McEwen's deposition is taken, was not falsified in this respect, they do not correctly state the facts?

A. My understanding clearly is that the daily balance-sheet was subsequently falsified as shown by the expert examination to make it agree with the other books.

Q. 54. In making your examination as I understand you, you examined the assets of the bank and then the liabilities of the bank and thus arrived at the net amount the bank had, is this correct?

A. We examined no book except the daily balance-sheet, with which we compared the reports as made out by Schardt.

Q. 55. In what way could you tell that the amounts reported by Schardt were correct?

A. We only had his word for it and the reports that he made to us and the exhibit on the daily balance book.

Q. 56. Then you relied upon the statements made to your com-

mittee by Schardt, without making or having made a thorough examination of the books?

57 A. Yes, sir, we relied upon Mr. Schardt and did not make an examination of any book except the daily balance sheet.

Q. 57. The daily balance book of which Exhibit 2 to McEwen's deposition is taken, shows the amount due individual depositors each day does it not?

A. It should show it at the close of business every day.

Q. 58. In what way did you verify this statement on that book?

A. The statement he made was on a separate sheet of paper from the daily balance-sheet and as I have stated before, after footing up his list, looking at the evidences of debt, comparing the two, then we compared that list with the daily balance-sheet to see whether or not they agreed.

Q. 59. You mean that you compared it with the sheet in the actual book or by a sheet furnished you by Schardt?

A. We compared the amount of the footings of these examinations with the book itself.

Q. 60. In what way did you verify the statement on the book kept by Schardt which should have shown and purported to show the amount due individual depositors?

A. We made no verification of it only in the manner in which I have stated.

Q. 61. Have you stated any manner in which you verified this particular account?

A. We took his word for it, which we had to do or go into an examination of all the books.

Q. 62. Was it not a custom in the bank as late as July, 1890, for the finance committee to have the individual book-keeper to furnish at intervals a trial balance from his books, which were compared with the amount on the daily balance book kept by Schardt?

A. I don't remember of this having been done.

Q. 63. I mean this: Was not the total amount shown to be due individual depositors on the individual ledgers, taken off at stated intervals which were called trial balances?

A. I did not understand it as trial balances. Mr. Schardt reported from time to time the amount due the depositors, but this account was falsified as his other books were.

Q. 64. Did Mr. Schardt keep the individual ledgers from the time he was teller?

A. Mr. Boensch was there, and my impression is that Mr. Schardt kept one of them and Mr. Boensch kept the other until Mr.

58 McDowell came in. I find on examination, before signing this deposition that they were kept mostly by Mr. Boensch.

Q. 65. Did you ever request the individual book-keeper to furnish your committee with the total amount shown on the individual ledgers to be due depositors?

A. Personally, I did not.

Q. 66. Did the finance committee?

A. I have no knowledge of it.

Q. 67. It is a fact is it not that if the finance committee had at

any time after the shortage commenced, procured from the individual book-keeper the total amount shown by his books to be due individual depositors and have compared it with the amount shown on the daily balance book kept by Schardt to be due individual depositors, would this not have at once disclosed the fact that something was wrong with the books?

A. I think it would, if the books had been kept right.

Q. 68. And do I understand you to say this verification was never made?

A. I stated that I had no recollection of its being done.

Q. 69. What constitutes the bills receivable shown in Exhibit 2 to McEwen's deposition, to be due the bank?

A. Bills receivable are notes due the bank.

Q. 70. Is it not a fact that this particular amount, about $8,334 represented entirely by the notes of the Grubbs Cracker Co., which has been out of existence for three or four years?

A. I cannot say what that represents without an examination of the books. I find upon examination of the books that over five thousand dollars of the above-named was against Wm. Moore, for which the bank had real estate pledged.

Q. 71. Is it not a fact that the bank carried such notes as a live asset for some time before the bank failed, when it was known that the paper was worthless?

A. I have no recollection of the bank for two or three years charging off any notes due it. I am one of those persons, though, that does not look upon a note as absolutely worthless, that is on a young, vigorous man.

Q. 72. Is it not a fact that the bank carried paper upon parties well known to be insolvent, and in this way made the surplus what it was?

A. The bank had some paper that I did not consider good.

Q. 73. About how much?

A. I cannot state.

Q. 74. Can you approximate it?

59 A. I cannot.

Q. 75. Who preceded Schardt as cashier?

A. Charles Sykes.

Q. 76. Were his accounts examined and verified?

A. Not by expert examination as Schardt's were.

Q. 77. Was a settlement made with him when he retired?

A. I don't understand that there was ever a formal settlement made with Mr. Sykes.

Q. 78. Did the bank, at the time he retired, have any reason to suspect that he was behind in his accounts?

A. I am compelled to say this in regard to that: On the 3rd day of January, 1893, Mr. Sykes submitted his report for the previous six months' business of the bank.

There were some things in that report that I thought were wrong. But before the report was discussed or accepted, I, together with others, was appointed a committee on salaries and retired from the room. In our absence the report was received by the bank and

ordered filed. Subsequent to that, though, I brought to it the notice of the directory that there were some $2,000 worth of stocks purporting to belong to the bank in excess of the amount that the bank held on the first of July, 1892. The finance committee had not ordered the purchase of any such stocks, and they were at a loss to know why they were in the hands of the bank. Thereupon, a committee of three was appointed to make a formal settlement with Mr. Sykes. They put themselves in correspondence with him, and it resulted in a lawsuit, which is still pending. There never was any settlement obtained, and there is now litigation going on.

Q. 79. When was the meeting at which you called the attention of the board to this matter?

A. I think it was soon after the other meeting held on January 3, 1893.

Q. 80. Did any of that matter go upon your minutes?

A. Yes, sir; the appointment of the committee did.

Q. 81. Was Mr. Lewis T. Baxter present?

A. Yes, sir; at the meeting on 3rd January, 1893.

Q. 82. Was he spoken to with reference to the matter you have detailed before?

A. Not then.

Q. 83. Was he later?

A. I don't remember it.

Q. 84. Who was cashier before Mr. Sykes?

A. Mr. Durr.

Q. 85. When was Sykes elected?

A. Books show he was elected 6th of January, 1890.

60 Q. 86. Was any shortage discovered in the accounts of Mr. Durr, as cashier?

A. Yes, sir; there was a difference between him and the bank in regard to commissions.

Q. 87. Was that reported to the directors?

A. Yes, sir.

Q. 88. Did Mr. Lewis T. Baxter know of it?

A. I don't think he did. I do not think Baxter was connected with the bank at that time. Since writing the above and after examination of the books, I find Baxter was connected with the bank, and the presumption is that he knew of it.

Q. 89. Did the minutes of the bank show that fact?

A. I will not be positive.

Q. 90. Was it generally known in the bank and among the directors?

A. It was known to some of us.

Q. 91. Did he resist payment?

A. Not by suit.

Q. 92. The bank's affairs were, to a certain extent, examined by an expert, were they not?

A. Yes, sir.

Q. 93. How long prior to that time had an expert examined the books of the bank?

A. I don't know as it had been done at all.

Q. 94. Do you mean to be understood that you allowed the bank to run from the fall of '90 to the time of its close without a thorough examination, and at the same time state that you relied upon the statements of Schardt in the absence of such thorough examination?

A. In answer to that I will say that I was not a paid official of the bank. I did not think that I had the right to appropriate money or to run the bank into any expense. I do not understand that it is the business of a finance committee in any bank to overhaul the entire books, and therefore I did not direct any thorough examination.

Q. 95. Why was it finally done in 1893?

A. It was done mostly because the Commercial national bank had failed. There were wild rumors as to the conduct of that bank by its cashier and president, and a few days after that failure I was elected president of the Mechanics' bank, and put in an attitude where I could say what ought to be done, and with the advice of some of the directors, had the examination made.

Q. 96. Did you know that during all these years that the guarantee company had excused and the bank held its bond on Schardt as teller?

A. I knew that he was insured in a guarantee company.

61 Q. 97. Did you ever read the bond?

A. I have, since the deficit.

Q. 98. Did you ever hear of Schardt's speculating before January, 1893?

A. I think I did.

Q. 99. Did you see the anonymous letter written with respect to his speculating?

A. I saw a letter directed to Judge John Woodward. Judge Woodward brought that letter to the bank and showed it to me and I asked permission to call Mr. Schardt up and show it to him, and he said he was perfectly willing that I should do so. I at once called Mr. Schardt to where we were and told him there was a communication I wanted him to read. He did so and his remarks were: "It is a lie and I can prove it." In this letter it was stated that Mr. Schardt was a partner in a bucket shop. I told Mr. Schardt that it devolved on him to prove it false. I at once reported the contents of this letter to the president of the bank, Mr. Baxter. Mr. Schardt asked that I and Judge Woodward remain there for a few minutes. He went out and got Frank Searight and Dr. Barry. Judge Woodward, Mr. Baxter and myself went into the rear of the bank building. Mr. Schardt and the other gentlemen came back and Mr. Schardt says: "Here are men who can tell you whether that is so or not." I asked them if they knew why we had sent for them and they said that Mr. Schardt had told them. Mr. Searight said some time before that Mr. Schardt, Dr. Barry and himself had agreed to open a brokerage association. They objected very much to the term bucket shop. Each one was to put in a small amount—$200, I think. Mr. Schardt, in a short time, became dissatisfied and sold his interest to Frank Searight at a small loss. Subsequent to

that I went to Mr. Schardt's house to see him, having heard again that he was speculating. I told him what I had heard and he said it was not so, that he did not own any stocks at all. I told him if he was he ought to quit that or quit the bank, and he said he had sold everything he had. I again heard that he was speculating, but from sources that I did not attach any importance to, as it all emanated from the same source as the anonymous letter. I again approached him and he denied it.

Q. 100. Was this just prior to the resignation of Judge Woodward as a member of the board?

A. I think it was.

Q. 101. Do you know when he resigned?

A. His resignation bears date Feb. 17, 1893. Was placed
62 before the board of directors and accepted March 25, 1893.

Q. 102. Did Mr. Baxter, the president, ever say anything to you about Schardt speculating?

A. I don't think he ever did.

Q. 103. Just prior or soon before the failure of the bank, did you not, in connection with other members of the board, guarantee the deposit of the building and loan association for about $18,000?

A. We did on the 29th day of March.

Q. 104. Are you contesting that claim by suit?

A. Yes, sir.

Q. 105. Please state the grounds of your denying liability.

A. We are clearly of the opinion that an imposition was practiced on us in order to get our names to that paper as surety.

Q. 106. Please explain how.

A. From the evidence in our possession we feel satisfied that they, the building and loan association, knew things concerning our bank that the directory of the bank did not know.

Q. 107. You mean, do you not, that you think the building and loan association had good reason to believe that Schardt was behind in his accounts, and the directors of the bank did not know this at the time they executed the paper?

A. Yes, sir.

Q. 108. And upon this ground you are contesting your liability?

A. Yes, sir.

Redirect examination:

Q. 109. From what you now know of the manner in which the defaults of Mr. Schardt was covered or hidden, would it or not have taken all the books of the bank, and an examination thereof, together with all the pass books to have made the detection?

A. I am not an expert accountant, but I so understand it.

Q. 110. Will the individual ledger which should show deposits, show the default made in money deposited, without the aid of the pass book?

A. No, sir; I think not.

Q. 111. Were the examinations made by the committee, the usual and ordinary examinations made by the national and State banks?

A. I have carefully inquired into this matter and I so understand it.

63 Q. 112. How long did it take the experts to take the account?

A. I cannot say—several months.

Q. 113. Was Schardt, while teller or cashier, required by any law of the bank, to keep an individual ledger or do work for it in this direction, or was it done by him voluntarily?

A. He was elected teller and book-keeper.

Q. 114. I will ask you if much of the paper held by the bank at the time of the failure of the Commercial national bank was injured by reason of that and other failures in this community?

A. Yes, sir; they were very much injured because it produced a panic and every kind of security depreciated in value.

Q. 115. Did Sykes' liability to the bank and for which he is now sued arise strictly and purely out of any defalcation such as taking money out of the bank, or are they debts arising out of negligence, contracts, etc.?

A. He is not a defaulter, but his liability is what we conceive to be an indebtedness to the bank.

Q. 116. In respect to notes taken by Sykes and sued upon in the State of Alabama, was that known until the receiver found it out?

A. No, sir.

Recross examination:

Q. 117. You have stated that you have thoroughly investigated the method of bank examinations. Was that before or after the shortage occurred?

A. Afterwards.

Q. 118. Do you know what methods of examination the banks used prior to the time the bank failed?

A. We used the same course of examinations as national banks do, as I understand it.

Q. 119. Are the books kept by the same parties and in the same ways in the national banks as they are kept in your bank?

A. I cannot say.

Q. 120. Did you ever hear of a cashier of a national bank keeping a general ledger and cash book?

A. I don't know that I did.

Q. 121. Did you ever hear of the teller doing so?

A. No, except in one instance at Springfield, Tenn.

Q. 122. Did Mr. Durr keep your cash book and general ledger while he was cashier?

A. I don't believe he did. Am not positive about it.

Q. 123. Did Mr. Sykes?

64 A. No, sir; only in the absence of Mr. Schardt.

Q. 124. You have stated that the shortage could not have been discovered by an examination of the individual ledger without comparing it with the pass books; is it not a fact that at any time after the shortage began the totals of the individual ledger when

compared with the totals shown on the daily balance book, have shown a large discrepancy?

A. Schardt's defalcation was such that it would have naturally shown that there was something wrong as it did when we commenced on it.

Q. 125. How long did it take Mr. McEwen to ascertain that there was a large shortage when he began on the books?

A. It was seven or eight hours before he reported that there was a discrepancy. He began in the morning and did not report until in the evening. I asked them what they based the shortage on, and they told me they had found a greater amount due individual depositors than was shown on daily balance book.

Q. 126. And upon this information, derived in a very few hours, you felt justified in going to Schardt's house and accusing him, a very sick man, of being a defaulter?

A. I did not accuse him.

Q. 127. You were present when Mr. Richardson did?

A. Yes, sir.

Re-examination:

Q. 128. And he admitted it when pressed?

A. Yes, sir.

Q. 129. And the experts have so reported it?

A. Yes, sir.

Q. 130. What was this alleged shortage of Durr as cashier?

A. As I understand it, he claimed to be owner of certain commissions made by him, while the bank people claimed that it had hired all his time and the commissions so earned should be turned over to the bank. There was no charge involving abstractions or embezzlement of the funds of the bank or otherwise.

Q. 131. After the failure of the Commercial bank and it became evident that all banks would suffer more or less, what did you do?

A. We took a number of collaterals of our bank and went to the American national bank and borrowed $50,000, the directors going upon the note. We borrowed this money believing that it would run our little bank safely over all troubles, or rather the
65 directors borrowed the money on their own paper and then our bank gave them its note and collaterals to indemnify them against loss.

Q. 132. How long after you became president before you set on foot an expert examination of the affairs of your own bank?

A. After the Commercial bank closed excitement ran high, and all were uneasy at its exposure, and a few days thereafter I called in the expert, McEwen, to go over our books.

Q. 133. You say in your cross-examination that it is not usual for tellers of national banks and cashiers to keep the individual ledgers, now, why was not this course pursued in your little bank?

A. It was a small bank and the service could easily be performed, while national banks require all the time of such officers for other duties, because of their larger capital and larger business. There was no by-law requiring the cashier or teller to do this work,

it was economical and voluntary on the part of such officers. We always had a clerk to keep the individual ledgers, and if he got pushed in his work the others would help him, and in this way the work goes on.

Recross-examination:

Q. 134. You have stated in question 111 that certain bankers had told you that the examinations in their banks were like the ones made in your bank, please state who these bankers were.

A. Well, I talked with Judge Woodward, who is on the finance committee of the American bank, and Joel F. Carter, of the First national bank, and I am under the impression that I talked with another man. These men stated that they did not go into the general books of the bank in their examinations.

Q. 135. In question 70 you have stated that over $5,000 of the bills receivable, as shown on your daily balance book, were on William Moore, secured by real estate.

—. ——.

Q. 136. Please state what constituted the remaining part of the bills receivable.

A. The remaining part, as I understand it without a thorough examination of the books, is a note or notes on H. B. Grubbs, on which the Grubbs Cracker Co. stock is pledged as collateral.

Q. 137. When did the Grubbs Cracker Co. cease to do business?

A. I don't know.

Q. 138. Was it not some years ago?

A. Yes, sir.

66 Q. 139. Has the stock since it ceased to do business been worth anything at all?

A. I have not investigated it, but presume it is worthless.

Q. 140. Were not the assets of the firm insufficient to pay its debts?

A. It is a matter I know nothing about, only just from general rumor.

Q. 141. Has or not H. B. Grubbs been insolvent for a number of years?

A. My understanding is that he has been insolvent.

Q. 142. How many years prior to the failure of your bank was it when Grubbs ceased to pay any interest on this debt?

A. He ceased paying interest before the bank closed, but how long before I do not know.

Q. 143. Is it not a fact that for two years before the bank failed that the bank held paper against insolvent parties which was counted in making the surplus of the bank what it was represented to be?

A. I don't remember of any paper that the bank held on insolvent parties except as against Grubbs.

Q. 144. In making up the statement for January 1, 1893, was not the paper against insolvent parties used, and counted at its face value?

A. We used some paper that might be considered insolvent, owing to the depreciation of collaterals placed on the notes as security. One instance, the Grubbs debt.

Q. 145. Then your financial statement of the condition of the bank the first of January, 1893, which showed a surplus of more than $25,000, was not correct, if the paper held by the bank had been estimated at its then value?

A. If you take out any notes that there might be a suspicion of their insolvency, the surplus was not properly shown, but until a doubtful debt or debts is charged off, my understanding is that it is usual to carry them as an asset. The surplus as shown by the books of the bank December, '92, is $27,116.63.

Q. 146. Is it not a fact that for two or three years prior to the failure of the bank, no paper was charged off?

A. I don't remember of any paper being charged off during that length of time. If there was, it was a small amount.

Q. 147. You knew, did you not, the first of January, 1893, that if the bank would then close down, it would not be able to realize the surplus as shown by its statement?

67 A. I don't think they would have realized a sufficiency if it had closed down at that time to have made the surplus as shown.

Q. 148. With reference to the suit against Sykes, is it not claimed that he purchased stock in the name of the bank for the purpose of aiding himself personally in certain enterprises?

A. My understanding of this is that Mr. Sykes used some notes against a certain Sheffield company that was due the Mechanics' bank in the purchase of stock in another Sheffield company, which stock was issued in the name of L. T. Baxter, M. A. Spurr, Frank Porterfield, and possibly himself or his brother.

Q. 149. Then did the bank receive new stock purchased with the notes of the bank?

A. It did not.

Q. 150. Is or not Sykes charged with fraudulent acts while cashier of the bank by which the bank lost either money or assets, in the suit against him which you have referred to before?

A. I don't know what is in the bill at all. I don't understand that he is accused of fraud. But the bank failed to get certain commissions due it, and the stock for which the notes (due the bank) was used in its purchase was not turned over to the bank, and certain stocks was thrust onto the bank January 1, '93, at a much larger price than the then market value.

Q. 151. Did the bank during the time that Durr was cashier, act as broker in buying and selling securities of all kind?

A. Yes, sir.

Q. 152. Did it charge a regular commission?

A. Yes, sir.

Q. 153. What officer of the bank had charge of the brokerage department?

A. The cashier.

Q. 154. Did the bank keep an account known as commission account?

A. Yes, sir.

Q. 155. Who procured the services of Prof. Jennings to examine the accounts of Durr?

A. My impression is that Mr. Richardson and myself went to see Jennings.

Q. 156. Why did you get Jennings to examine the accounts?

A. Because we thought there was some irregularity in his accounts?

Q. 157. What was the substance of Jennings' report?

A. Prof. Jennings reported, as I recollect it, that he had
68 ascertained that Durr had collected and failed to report about $1,100 in commissions.

Q. 158. When this report was submitted, then what happened?

A. Mr. Durr paid the amount assessed against him, protesting then and always has protested that it was wrong.

Q. 159. He did not deny having received this money did he?

A. I don't think he did.

Q. 160. Is it not a fact that immediately upon the report of Prof. Jennings being made, that one of your officers wrote Durr's resignation as cashier, and handed it to him to sign?

A. I don't know.

Q. 161. He did resign at once, did he not?

A. Yes, sir. He resigned Dec. 14th, 1889.

Q. 162. Did the bank not run on until the next annual meeting without any cashier at all?

A. Without reference to the books I am unable to state when Mr. Durr's resignation took effect, and his successor was elected. I have examined the books and find that Mr. Sykes was elected at next meeting of board Jan. 6th, 1890.

Q. Was or not this Durr's contention, that he was entitled to half the commissions and the bank the other half; and was not the $1,100 the one-half retained by him?

A. I don't recollect exactly how this was.

Q. 164. Was it not ascertained that the method by which Durr obtained these commissions and retained them, was by changing the method of keeping the account of the commissions on the books of the bank?

A. I don't remember.

Q. 165. Please explain what you mean when you say that Judge Woodward and Mr. Joel Carter stated that the examinations in their bank were like those made by your bank.

A. What I mean is this: I understand from those gentlemen that a list of the evidences of debt due the bank was made out by their clerk, and the clerk would call over these amounts, the finance committee seeing that they agreed with the securities on hand. Then the total was compared with the general ledger to see if it corresponded, the difference being that their total footings was compared with the daily balance book. The results so far as our bank was concerned would have been the same as Schardt falsified

the general ledger and then falsified the daily balance book
69 to make it correspond with the ledger and only an expert examination of all the books would have brought it out.

Q. 166. Then your meaning is that they stated that their examination of the assets of the bank were a similar to the examinations of the assets made in your bank?

A. Yes, sir; that is the way I understand it.

Q. 167. You do not mean to say what examination was made with reference to verifying the liabilities of the bank, do you?

A. No, sir; there was nothing said in regard to that between the gentlemen I spoke to and myself.

When this deposition was taken, in answer to question No. 61, I said, "We took his word for it." After the deposition was written out and given to me to read over and sign, I added the rest of the answer as set forth.

J. M. EATHERLY.

Deposition of Maj. James J. Pryor, Taken by Consent in the Above Cause.

Q. 1. Please state your age, occupation and present residence.

A. Aged fifty-five years. I am a book-keeper. At present I am assignee of Mechanics' Savings Bank and Trust Company.

Q. 2. Please state whether you employed any one to go through the books of the bank with a view to ascertaining its condition, if so, whom did you employ, and what are the respective characters of these gentlemen as expert book-keepers and accountants?

A. I employed Prof. R. W. Jennings and Samuel D. F. McEwen. They are both capable accountants and I believe they stand high as expert book-keepers among people who know them.

Q. 3. When you employed experts to pass over the books, did you notify any one to put in a book-keeper, if so, whom, and what answer did you get?

A. I asked Guarantee Company of North America to put in an expert accountant with those I engaged. They declined to do so. I invited Union Bank & Trust Co., adm'rs of John Schardt, to furnished an expert. I also asked Mr. Schardt's relatives to send Mr. Allen B. Fisher to examine with us, as I understand that Mr. Schardt had requested that Mr. Fisher be allowed to examine the books in his interest and behalf.

Q. 4. Please state whether or not you are a book-keeper and whether you have gone through the accounts of John
70 Schardt as cashier and teller of said bank, and whether Exhibit X is correct in respect to his embezzlements and defalcations.

A. I am a book-keeper. I did not go over all the scope of examinations in exact details with the experts engaged to do the work, but I aided in part of the work, and verified the footings of Exhibit X, though I did not follow out the interest calculations.

Q. 5. Please state whether or not the bank was a State or national bank.

A. It was a State bank.

Q. 6. State who were the executive officers of said bank.

A. J. M. Eatherly, president; Wm. Porter, vice-president; John Schardt, cashier, and Frank Boensch, Jr., teller, at time of assignment by the bank. Just previously L. T. Baxter had been president; Wm. Porter, vice-president; Chas. Sykes, cashier, and John Schardt, teller.

Q. 7. State whether John Schardt is now living or dead. If the latter, when he died, and who administered upon his estate.

A. Schardt is dead. Died 17th day of April, 1893. Union Bank & Trust Co., of this city, administered upon his estate.

Q. 8. Please state what offices in said bank Schardt filled, and during what time he did so.

A. He was teller and collector up to the first days in Jan., 1893, his bond as such teller was paid for up to Jan. 16th, 1893, but about first day of January, 1893, he was made cashier, and his bond as cashier dates 1st of January, 1893.

Q. 9. Please state whether his original bond as teller and collector was renewed from time to time annually until he was elected cashier on January 1st, 1893.

A. It was—payment made till the 16th of January, 1893.

Q. 10. What books did the bank keep or have?

A. A general ledger, individual ledgers, cash book, deposit register, check register, discount register and such other auxiliary books as experience showed to be necessary for the business.

Q. 11. Please set out the by-law relating to the duties of the cashier and teller as taken from the minutes.

A. Sec. 10, page 11, on Minute Book, shows duties of cashier, defined by by-laws, as follows: "The cashier shall have the general supervision and control of the business of the bank, except as otherwise provided. He shall see that all the accounts and books
71 are properly kept, and submit the report of the finance committee at each semi-annual meeting." Section 14, page 11, on Minute Book, shows duties of the teller defined by by-laws as follows: "The teller shall also be the general book-keeper of the bank, and shall give bond in the sum of $10,000.00 with two or more acceptable sureties to the finance committee. One-half of the bond shall be in some acceptable guarantee company, and the other half in personal security, but the teller may at his option give the whole bond in the guarantee company."

Cross-examination:

Q. 12. When were the by-laws adopted which you have referred to?

A. December, 1885.

Q. 13. What do you mean by deposit register?

A. Where there is a record kept of deposits made by depositors.

Q. 14. Explain the nature of it.

A. It is a record book where all deposits made by depositors are recorded and posted from there to the individual ledgers.

Q. 15. What do you mean by check register?

A. The checks paid by this bank arranged alphabetically on the check register.

Q. 16. What was the capital stock of the bank?

A. $50,000.

Q. 17. Was the cashier paid a salary for his services?

A. He was paid a salary I understand.

Q. 18. What amount of commercial paper was received by you as assignee?

A. There was turned over to me: Cash, $19.46; discounts, $31,005.22; demand-loan notes, $3,598.65; accounts, $6,342.14; bills receivable, $3,162.50; overdrafts, $12,709.56.

Q. 19. What amount of the bank's paper was hypothecated with the loan from the American national bank referred to by J. M. Eatherly?

A. Just a little above $100,000.

Q. 20. How much of the above assets have you collected?

A. I have collected about $14,000.

Q. 21. About how much of the paper in your hands was against insolvent parties at the time you received it?

A. I cannot tell you. I know that the Grubbs debt was insolvent.

Q. 22. Do you know how much of the paper as collateral with the American national bank was insolvent?

72 A. No, I do not.

Q. 23. Did you find any record in the bank of any paper having been charged off within the last two or three years of its existence?

A. I have seen no record of anything of the sort.

Q. 24. What has become of the Moore debt referred to by J. M. Eatherly?

A. The property was sold Saturday, the 10th of this month, under decree of the court.

Q. —. Will this trust receive any part of the proceeds of that sale?

A. I look for something.

Q. 26. In what way?

A. The excess above the lien and expenses on the property will certainly distribute something among the creditors, but the real estate is subject to advance bids, and we think it will bring more than the sale indicated.

Q. 27. At this time do you intend to advance the bids or do you know any one else who intends to do so?

A. I heard a disappointed bidder saying he would advance the bid, and the purchaser challenged him to do it now. I presume the intent was to advance the bid.

Q. 28. What are the total liabilities of the bank?

A. About $203,000 ascertained with a probability of a little increase.

Deposition of A. W. Harris, Taken by the Complainant.

Q. 1. Please state what experience you have had in the banking business, and what position you now fill, and have heretofore filled, and what is the capital stock of the bank?

A. I have been in the banking business twenty-five years; I commenced as a clerk and am now cashier of the American national bank and its capital stock is one million dollars.

Q. 2. Is it possible for a clerk or other agent of a bank to embezzle its money without detection at the time where trial balances are made and had every few days or at short intervals?

A. If the entries were very few and you had some one or a committee to pass over and examine original entries and items, yes, sir. Otherwise, no, sir. I believe that any scoundrel could evade detection from any finance committee or board of examiners under any system of book-keeping known to banks, without detection.

73 Q. 3. Is it the habit of finance committees to accept as correct statements made to them from time to time, by the officers and clerks of the bank?

A. It is.

Q. 4. Are such committees in the habit of examining original items and adding up columns, or merely accepting it as correct?

A. They are not and do not.

Q. 5. Under any book-keeping known to banks, what is the only mode of preventing embezzlement?

A. Honest men.

Q. 6. Have you in your observation and experience known of an instance in which every book required by the banking laws of the United States to be kept, was kept by a bank, and the taking of trial balances was done daily, and yet money was lost and undetected for a long time?

A. I have known it to cover a period of three years and to the amount of sixteen or seventeen thousand dollars.

Q. 7. And you took off daily trial balances?

A. Yes, sir; and the trial balances were all right, according to his showing.

Q. 8. Is it possible to get the exact financial condition of a bank without stopping for a while and calling in the pass books and having an expert go through this whole thing?

A. It is not.

Further deponent sayeth not.

A. W. HARRIS.

Subscribed and sworn to before me on this 5th day of March, 1895.

BUFORD DUKE,
Notary Public.

Cross-examination:

Q. 1. Do you think that any scoundrel could steal the full amount of your capital stock and surplus without detection?

A. With ordinary care it would be impossible.

Q. 2. Your bank is examined at least once a year by national bank examiners?

A. Yes, sir.

Q. 3. What method does your executive committee pursue when it makes an examination of the bank?

A. It makes quarterly examinations of the bank. It counts all the cash; it goes through in detail with the discounted
74 notes and demand loans; it verifies the amount of cash and amount of notes on hand by the books. They go through the notes in detail and then see that the amount of them is verified by the books.

Q. 4. Does your bank require trial balances from the individual ledgers, and if so, what is done with them?

A. Yes, sir; it is required once a month and they are verified by the general ledger balances.

Q. 5. Suppose a bank should not require a trial balance from the individual ledgers for more than two years, what would you say as to the degree of care exercised by the bank officers?

A. It would be very loose.

Q. 6. Suppose the teller kept the general books and the individual books were kept by an individual book-keeper, would it or not be grossly negligent in the bank officials not to have a trial balance from the individual ledgers, and compare it with the general ledger for more than two years?

A. It would.

Q. 7. Would it be possible to know anything about the condition of the bank without knowing this?

A. An accurate résumé of the business would demand it.

Q. 8. Is it customary in your bank, and others, so far as you know, for the executive committee to make an examination to see that the trial balance from the individual ledgers agrees with the amount shown on the general ledger to be due individual depositors?

A. The executive committee sees every morning the amount due individual depositors, and the officers of the bank constantly see that the individual ledgers and the general ledgers agree.

Q. 9. You have stated that the only mode of preventing embezzlement is honest men; please state whether or not a teller could, through a period of years abstract large amounts of money from the bank, and allow his books to be entirely out of balance with the individual ledgers and not be caught.

A. I should think his being out of balance would detect him.

Q. 10. Suppose the teller in a bank kept all the books except the individual ledger, which was kept by another man, and suppose the books kept by the teller were out of balance with the individual ledger in an amount exceeding $19,000, and the bank should certify

that the accounts of the teller had been examined, and found correct; would you regard this as a grossly negligent statement,
75 supposing the capital stock to be $50,000 and its surplus $27,000?

A. I would.

A. W. HARRIS.

Endorsed: Filed May 15, 1895. H. M. Doak, clerk.

Deposition of Frank Boensch, Taken by Consent Nov. 5th, on Behalf of the Defendant Company.

Q. 1. State your age and residence.

A. Twenty-five years old and live in Nashville.

Q. 2. Were you at any time connected with the Mechanics' Savings Bank & Trust Co.?

A. Yes, sir.

Q. 3. When and in what capacity?

A. I was clerk from 1888 until the bank closed.

Q. 4. Did you at any time keep the individual ledger in the bank?

A. Yes, sir.

Q. 5. When did you begin and when did you stop?

A. I began in the early part of 1890 and continued to keep the books until the bank closed

Q. 6. Were you at any time during that period required to take from the individual ledger a trial balance, and if so, during what time and was a record kept of such trial balances?

A. Yes, I was required to take off a trial balance from the time I begun until about the time that Durr left the bank the last of 1890. After that time Mr. John Schardt told me that it was not necessary to take off trial balances any longer and thereafter none were taken off. At first a trial balance was taken off every two weeks and later once a month. There was a book in the bank called a trial-balance book in which these balances were entered when they were taken off.

Q. 7. Did these trial balances always agree with the amounts shown to be due individual depositors on the general ledger account kept by Schardt?

A. They did except occasionally when the balances were first taken off there would be an error or discrepancy between my books and the general ledger, and we would have to go back and check off until we found the error and made my balance agree with the balance on the general ledger, which was always done before we stopped.

76 Q. 8. Then do you mean to say that from the latter part of 1890 until the time the bank closed you could never tell whether your individual ledgers agreed with the amounts shown to be due individual depositors on the general ledger?

A. Yes, sir.

Q. 9. Should the amount due individual depositors as shown by

your books have agreed with the amount shown to be due individual depositors on the daily balance book and the general ledger?

A. Yes, sir; the daily balance book is merely a copy of the total amounts shown on the general ledger.

Q. 10. Did you work in the bank while Mr. Durr was cashier?

A. Yes, sir,

Q. 11. Why did he leave the bank?

A. I think because he was required to resign.

Q. 12. Did you know that he was short?

A. I knew in a general way of the shortage and knew that he paid up what the bank claimed, but I never knew the details because it was kept from me.

Q. 13. In taking off the trial balances from your books, state what you did, how and when you did it?

A. I added up the amount shown to be due each depositor on my book of that date and then added the total together. I did this always between the close of business one day and the opening of business the next day. The work would always necessitate my doing a part of it at least at night.

Q. 14. Was it necessary to do the work between business hours?

A. Yes, sir; because the books would be constantly changing during business hours.

Cross-examination by E. H. East:

Q. 15. Were you under the orders of the cashier, Schardt?

A. Yes, sir.

Q. 16. Was it in obedience to his orders that you ceased to keep or take off the trial balances?

A. Yes, sir.

Q. 17. What was the trouble between Durr and the bank officers?

A. It was a difference between them in respect to the ownership of some commissions, arising from the sale of stock for outside parties and the bank.

Q. 18. What was the force of the bank?

A. Three at all times, consisting of Schardt, myself, Gillespie part of the time, and McDowell.

77 Q. 19. What did you do?

A. I was clerk, but helped the others when directed. I was teller in 1893, from January until the bank assigned.

FRANK BOENSCH, Jr.

Endorsed: Filed May 15, 1895. H. M. Doak, clerk.

Deposition of Chas. Sykes, Taken by Defendant.

Q. 1. Where do you live?

A. Nashville, Tennessee.

Q. 2. Were you at any time cashier of the Mechanics' Savings Bank & Trust Company?

A. Yes, sir.

Q. 3. Who did you succeed as cashier?
A. Durr.
Q. 4. Who succeeded you?
A. John Schardt.
Q. 5. Were you cashier of the bank during the whole of the year 1892?
A. Yes, sir.
Q. 6. Did you at any time during that year receive information that John Schardt was speculating; if so, state when, how and all the circumstances?
A. Yes, sir; I did receive such information. Some time in the summer or fall of 1892 a gentleman by the name of Kyle came here from New York, representing Myers & Co., of New York. Kyle wanted me to become interested in the brokerage business and represent Myers & Co. at this point. I told him that I did not like the idea because it would be purely a speculative business, and he then said that that made no difference; that John Schardt, our teller, was a part owner in a similar concern.
Q. 7. Did you impart this knowledge to any one; if so, whom?
A. Yes, sir; I once told Mr. L. T. Baxter, the president of the bank, of the conversation.
Q. 8. Did you say anything to Schardt about the matter?
A. Yes, sir; on the next day, I think I told Mr. Schardt of what Kyle had said.
Q. 9. What did Schardt say to you in reply?
A. He admitted that he had at one time been interested in such a concern, but had sold his interest; and that he had speculated to some extent, but had made money on every transaction, and had seen the error of his way, and had ceased to do so any more.
78 Q. 10. Did you impart this information received from Schardt to any one connected with the bank, if so, whom?
A. Yes, sir; I immediately told Mr. Baxter, the president of the bank, what Schardt had said.
Q. 11. Did you receive any other information at any other time with reference to Schardt's speculating?
A. Yes, sir; some time thereafter I received an anonymous letter telling me that Schardt had been speculating.
Q. 12. What did you do with it and what became of it?
A. I showed it to Mr. L. T. Baxter, the president, and he said not to pay any attention to an anonymous letter, and I spoke to Schardt about it, and he said he thought he knew the author, and asked me to let him have the letter, and he would bring the party before me and make him acknowledge it was false.
Q. 13. Did you give him the letter and did he bring the party before you?
A. I gave him the letter, and asked him about it more than once, and he always replied that he was working on it.
Q. 14. Did you tell Mr. Baxter of this conversation?
A. I think I did.

Cross-examination:

Q. 1. Were you cashier of the bank for two or three years before January 1, 1893, and was Schardt teller during this same time?

A. I was elected cashier in December, 1889, and remained as such until the early part of January, 1893. During that time Mr. Schardt was the teller and general book-keeper.

Q. 2. Where does the president, Lewis T. Baxter, now live?

A. Mr. Lewis T. Baxter is at present in the State of New York. I do not know that he considers that his home.

Q. 3. Did you or not sign several of the certificates for the annual renewal of Schardt's bond as teller?

A. I did sign several applications for the renewal of Mr. Schardt's bond, but did so on the fact that the finance committee said his accounts were correct.

Q. 4. Did you not recommend Schardt to Mr. Porter and Sanford Duncan as a fit and proper man to take your place as cashier when you resigned?

A. I do not remember that I recommended Mr. Schardt as my successor to either Mr. Wm. Porter or Mr. Duncan. I may have done so, however. If Mr. Porter says I did, I suppose I did.

79 Q. 5. Who prepared and put before the board of directors, at the semi-annual meetings, the statements of the officers of the bank?

A. It was my custom to prepare semi-annually a statement from the daily balance book, kept by Mr. Schardt, and submit the same to the finance committee as my report; this same report then was made to the directors.

Q. 6. If you state that you prepared and laid before the directors such a statement, please state if they were not honestly and fairly made out?

A. All reports made by me were honestly made from what appeared on the daily balance book.

Q. 7. How often did the finance committee meet and examine statements made to them by executive officers, count the cash and examine into the condition of the bank financially?

A. The finance committee were supposed to meet quarterly for the alleged purpose of examining the condition of the bank. They met semi-annually to examine statements made by the officers. I cannot say how often they made any examination, as I was not present when these supposed examinations were alleged to have been made.

Q. 8. Is there not now pending litigation between you and the assignee of the bank?

A. There is.

Endorsed: Filed May 15, 1895. H. M. Doak, clerk.

Deposition of William Porter, Taken by Complainant.

Q. 1. Please state if you were a director in the Mechanics' Savings Bank and Trust Company, and if you had a conversation about

January, 1895, with Charles Sykes in regard to his successor as cashier?

A. I was a director in the bank and did have such conversation at the time mentioned, and he did recommend John Schardt as a suitable man to take his position as cashier.

Cross-examination:

Q. 2. How long were you connected with the said bank?

A. From its organization to its close.

Q. 3. Were you, during that time, a member of the executive committee?

80 A. I was not.

Q. 4. Were you at any time a member of the executive committee?

A. No, sir; I was made vice-president when the bank commenced and remained that way to the close.

Q. 5. Did you have anything to do with the examination of Schardt's accounts from time to time?

A. I was present frequently, but I took no part in it.

Q. 6. Were you at the bank often?

A. No, sir. I was there in July and January, and that was about all.

Q. 7. Why did you make inquiry of Sykes as to Schardt?

A. Knowing that Charley was retiring, and we had to have a cashier, I asked Sykes about Schardt's ability; there was no question as to his integrity; it was as to his ability I was asking.

WM. PORTER.

Filed May 15, '95. H. M. Doak, clerk.

Deposition of James McLaughlin, Taken by Defendant.

Q. 1. State your residence and occupation.

A. Nashville; cashier of the Merchants' bank.

Q. 2. What is the capital of your bank?

A. $150,000.

Q. 3. How long has the bank been in existence?

A. Since 1886.

Q. 4. What force do you work in your bank?

A. We have a president, cashier and teller, and two book-keepers, one of them is a general book-keeper and the other assists the teller in keeping the individual ledgers.

Q. 5. Do you require the individual book-keeper to make out a trial balance from his individual ledgers, showing the amount due depositors?

A. We require that to be done monthly—the name of the depositor and the amount due is credited.

Q. 6. Is this compared with the amount shown to be due on the general ledger?

A. Yes, sir.

Q. 7. If there is a discrepancy, what is done?

A. The work has to be checked back over until the error is discovered.

Q. 8. Is there any way of telling what the liabilities of the bank are, without having a trial balance from the individual books?

81 A. No, sir, I know of no other way.

Q. 9. Is that the general custom of banks?

A. That is my impression.

Q. 10. Suppose your teller was also your general book-keeper how would you go about verifying his accounts?

A. In that event the teller would keep his own books and would make off his statement every month. Then the individual book-keeper would make a trial balance from his books and these would be compared.

Q. 11. What do you understand the following language to mean: "The accounts of the teller have been examined and verified"?

A. I understand it to mean that you have to verify his statements by outside corroborative proof.

Q. 12. Is there any way of verifying in this manner the accounts of the teller in a bank where he is also the general book-keeper?

A. Yes, sir; there is a way of doing it.

Q. 13. How long have you been in the banking business?

A. I have been in the banking business since 1870, more or less.

Q. 14. Are you a practical book-keeper?

A. Yes, sir.

Q. 15. Are you thoroughly posted in that line of business?

A. Yes, sir.

Q. 16. Suppose the teller in a small bank kept the general books, and suppose the bank examiners did not procure a trial balance from the individual book-keeper showing the amount due depositors, and certified that they had examined and verified the accounts, would this be a true statement?

A. It would not be a correct statement.

Q. 17. Did you ever hear of a bank, or know of an instance in which no trial balance was taken from the individual ledgers for more than two years?

A. I don't know of any instance of that kind.

Q. 18. If a bank acted in this way, would you consider it good banking?

A. I would not consider it safe banking.

Q. 19. Would the bank officers be able to tell the condition of the bank?

A. I think not.

JAS. McLAUGHLIN.

82 Cross-examination by Judge EAST:

Q. 1. Where the finance committee is the body to look over quarterly the accounts of the officer, is it usual for the committee to do more than pass over and compare statements laid before them by the executive agents or clerks, count the money and compare assets with statements?

A. Is *it* usual to count the cash, examine and compare the assets

with the statement and compare the statement with the footing of the journal.

Q. 2. Is it customary for finance committees of banks to go through the books and look up original entries?

A. Not unless they have their attention called to some particular matter. It is not customary.

Q. 3. Suppose a teller were to receive money for a depositor and then make the entry in the pass book, then tear up the ticket of the depositor, would the books show anything thereof?

A. No. They would show nothing of the transaction at all. Nothing.

Q. 4. In such case would a trial balance of any other statement for the books throw any light upon the financial condition of the bank?

A. No.

Q. 5. It is customary for the teller or cashier in small banks to keep the general ledger?

A. Either the general ledger or the individual ledger. Yes, sir.

Q. 6. It is not customary in small banks in Nashville for the teller to keep the general ledger?

A. Yes, sir.

Endorsed: Filed May 15, '95. H. M. Doak, clerk.

Deposition of Charles B. Duncan, Taken by Defendant.

Q. 1. Where do you live?

A. Nashville.

Q. 2. Have you had any experience in banking, if so, how much?

A. Yes, sir; I was clerk in the Fourth national bank for a few months, in the Merchants' bank for about two years, and in the First national bank about four years, and in the Bank of Commerce for about four years, and I was in the First national bank at South Pittsburg for about six months.

83 Q. 3. What position did you fill in the Bank of Commerce and in the bank at South Pittsburg?

A. Cashier of the Bank of Commerce and assistant cashier of the bank at South Pittsburg.

Q. —. Where are all of the banks located of which you have spoken except the bank at South Pittsburg?

A. Nashville.

Q. 5. Are you an accountant and book-keeper?

A. Yes, sir.

Q. 6. Are you thoroughly familiar with the system of banking?

A. Yes, sir.

Q. 7. Are you familiar with the usual and ordinary method of examining banks?

A. Yes, sir.

Q. 8. What was the capital stock of the Bank of Commerce?

A. Thirty thousand dollars.

Q. 9. What force did you have in the bank?

A. We had a teller and book-keeper, besides the officers.

Q. 10. What books did the teller keep?

A. The individual books.

Q. 11. Do you or not mean the individual ledger?

A. Yes, sir.

Q. 12. Was it customary to take off trial balances from the individual ledger, if so, how often and what was done with them?

A. Yes, sir; it was customary, and they were taken off at least once a month, and these balances were compared with the balances shown on the general ledger representing the amount due individual depositors.

Q. 13. Did you have a daily balance book?

A. Yes, sir.

Q. 14. How were the affairs of the bank examined with reference to its assets and liabilities?

A. We took the daily balance book and counted the notes on hand, the cash, stock and bonds, and other items of asset shown on the book and verified them. We then took a trial balance from the individual ledgers, and compared this with the amount shown to be due individual depositors on the general ledger and the daily balance book, and if these compared correctly, we felt that the bank was all right.

Q. 15. Is it necessary to go through all of the books, in making examinations in a bank, in order to ascertain whether the amount shown to be due individual depositors on the individual
84 ledgers, agrees with the amount shown to be due individual depositors on the general ledger?

A. It is not necessary—all you have to do is to take your trial balance from the individual ledger and compare it with the amount shown to be due on the general ledger.

Q. 16. Is this customary and usual in bank examinations?

A. Yes, sir.

Q. 17. What do you mean and what is generally understood, by stating that the accounts of a teller or other person have been examined and verified?

A. It means that their accounts have been examined and verified by evidence other than the statements of the person who is being examined.

Q. 18. Was the Bank of Commerce a State bank?

A. Yes, sir.

Q. 19. Did it do a brokerage business?

A. Yes, sir.

Q. 20. To whom did the commissions belong?

A. They belonged to the bank.

Q. 21. If the cashier should withhold commissions earned by the sale or purchase of stocks and bonds, would there be any difference, so far as the bank was concerned, between that and taking money out of the drawer?

A. None whatever in my opinion.

Q. 22. Is it customary and usual in all banks to examine and

verify the accounts of the employés of the bank in the way you have indicated?

A. Yes, sir.

Q. 23. Suppose the teller kept the general ledger, how would you verify his accounts?

A. In the same way that you would if he kept the individual ledger.

Q. 24. Does the amount of the trial balance from the individual ledgers always agree with the amount of the general ledgers?

A. There are some small discrepancies which are easily found by checking back.

Q. 25. Is it customary and usual to require these errors to be discovered as soon as it is ascertained that the balances do not agree?

A. Yes, sir.

Q. 26. If there was a discrepancy of several thousand dollars between the two statements, would or not this create a suspicion that something was wrong?

A. Yes, unless found within a very short time.

85 Cross-examination of CHAS. B. DUNCAN by E. H. EAST:

Q. 27. Is it not customary in Nashville in cases of banks with small capital for the teller or cashier to keep an individual ledger or a general ledger?

A. Yes, sir.

Q. 28. How was this done in the Bank of Commerce?

A. The teller in the Bank of Commerce at one time kept the general ledger, and later kept the individual ledger.

Q. 29. Please state how the bank at South Pittsburg managed its affairs in this respect.

A. When I was connected with it I was assistant cashier and teller, and also kept the individual and general ledger.

Q. 30. When did the Bank of Commerce close and make an assignment?

A. March 25th, 1893.

Q. 31. Is it customary for the finance committee on their quarterly examinations to go to the original books and foot up columns and examine original items or entries, or do they merely accept statements made to them by the officers and clerks of the bank?

A. No, sir; they accept statements made to them by the executive force and clerks as shown by the books of the bank and do not examine original entries. They count the cash and compare the assets with the statements. Such is the habit.

Q. 32. When there is no suspicion of the integrity of the officers or clerks, is it customary or usual to call in outside witnesses at these meetings of the finance committee to determine whether the accounts are correct or not?

A. No, sir.

Q. 33. Is it possible in a bank where you have one or more dishonest clerks or officers to detect from the books alone embezzle-

ments made by such without calling in pass books, stopping in a large degree the business of the bank, and taking a general account?

A. It is impossible without calling in the pass books and stopping, to a large degree, the business of the bank.

Q. 34. Do you not know of a case where they kept all of the books, took off trial balances daily, and where there was but one man implicated, yet he got $16,000 or $17,000 out of the bank?

A. Yes, sir; there is one such case in Nashville.

Q. 35. Is there any such thing as detecting embezzlement in all of its forms and many of its forms by mere examination of the books of the bank?

86 A. No, sir.

Q. 36. Is there any mode of book-keeping known to banks, or used by banks, by which a dishonest employé can be detected through the books?

A. In some instances it can be detected by the books alone. There are others in which it cannot be detected alone from the books.

Q. 37. When the finance committee meets and has its statement furnished to them by the employés, showing the results of the books, and have counted the cash and compared the assets with the statements thereof furnished them by the officers of the bank, is not these things what is known as having examined and verified the accounts of employés?

A. Yes, sir.

Q. 38. Do you know of any instance in which outside testimony was called in by a finance committee where there was no suspicion of the integrity of any of its officers or executive force?

A. No, sir.

Q. 39. Was the Bank of Commerce a State bank?

A. Yes, sir.

Redirect examination:

Q. 40. In answer to question 27 you say that it is the custom in Nashville in small banks for the teller or cashier to keep some of the books. Do you mean to say that you know of a bank in which the cashier keeps any of the books?

A. I don't know of a bank where the cashier ever did keep any books.

Q. 41. Why did you keep the books in the bank at South Pittsburg?

A. Because the bank had just started. It was a small bank and there was no one else in it but myself.

Q. 42. Was or not that a temporary arrangement?

A. Yes, sir.

Q. 43. How long did it last?

A. About three or four months.

Q. 44. In answer to question 31 you state that it is not customary for the finance committee on their quarterly examinations to ex-

amine original items or entries—do you mean to be understood as saying that the footings on the books themselves are not compared?

A. No, I mean to say the footings on the books themselves are compared, and in most cases where the original items are not examined, the original entries are.

Q. 45. Is it necessary to stop the business of the bank at
87 all in order to see that the amount of notes and discounts on hand agree with the amount shown to be on hand by the daily balance book?

A. No, sir; I don't see why it is necessary at all.

Q. 46. Is it necessary to stop the business of the bank in any degree to have a trial balance taken from the individual ledger and compared with the amount shown to be due individual depositors on the daily balance book or general ledger?

A. It is not necessary.

Q. 47. What case do you refer to in answer to question 34?

A. I refer to the case of Allen in Capital City bank.

Q. 48. What is your understanding of the method in which Allen got the $16,000 or $17,000?

A. Allen was teller of the bank and as I understand it, he used the money deposited by customers and held back the deposit tickets.

Q. 49. Then his books, if they had been examined, would not have shown the shortage?

A. No, sir.

Q. 50. In answer to question 37 do you mean to be understood as saying that the finance committee has performed its duty when it has compared assets of the bank with the statements furnished them by the clerks from the books?

A. No.

Q. 51. Please explain what you mean.

A. The finance committee should compare the assets with the statements shown on the books themselves, and not the statements furnished by the clerks themselves.

Q. 52. Suppose in a bank having a capital stock of $50,000 and a surplus of $28,000, and the individual ledgers showed $19,000 more money due depositors than the daily balance book showed, and the finance committee should examine the bank, and not find this discrepancy, what would you say as to the carefulness of such an examination?

A. I should say that it was not a careful examination nor a thorough one.

Q. 53. Suppose in the same bank the notes and discounts on hand were less by $3,000 than the amount shown to be on hand by the daily balance book, and the executive committee or finance committee should not discover the difference in making an examination, what would you say as to the carefulness of such an examination?

A. I should say that that was neither careful nor thorough.
88 Any discrepancy as high as $500 or $600 should be discovered in any kind of an examination.

CHAS. B. DUNCAN.

Sworn to and subscribed before me this the 15th day of April, 1895.

[SEAL.] W. A. CARSON,
Notary Public.

Endorsed: Filed May 14, 1895.

Deposition of Allen B. Fisher, Taken by Defendant.

Q. 1. State your residence and occupation.

A. Nashville; book-keeper.

Q. 2. How long have you been engaged in this business?

A. About seventeen years.

Q. 3. Are you thoroughly familiar with book-keeping in use in banks in this part of the country?

A. I am.

Q. 4. Is it or not customary for banks to take from individual ledgers a trial balance at stated intervals, and if so, how often?

A. It is—every two or three weeks.

Q. 5. Are these trial balances verified with any book, if so, which one?

A. With the balances on the general ledger.

Q. 6. Is there any way of telling the condition of the bank without doing this?

A. There is not.

Q. 7. What do you understand by one saying that the accounts of a man have been examined and verified?

A. I would understand it to mean that the accounts of the man to be examined, are to be taken and then proved to be correct from information received from other sources than the person whose accounts are being examined.

Q. 8. What bank, if any, are you now connected with?

A. The Union Bank and Trust Co.

Q. 9. How often does this bank require trial balances to be taken from the individual ledgers?

A. Every two weeks.

Q. 10. Did you examine the accounts of Schardt in the Mechanics' Savings Bank & Trust Co. with McEwen and Jennings?

A. Yes, sir, I partially examined the books with Jennings during the year 1893, after the bank closed.

89 Q. 11. Did or not John Schardt from 1890 until the bank closed, keep a general ledger in that bank?

A. He did for some time before the bank closed, but I don't remember when he begun.

Q. 12. Suppose a statement had been made to you by the finance committee of that bank to the effect that they had examined and verified the accounts of Schardt, state what you would understand that to mean.

A. I would understand that to mean that a statement of the accounts of Schardt had been taken as a basis, and then this statement had been verified by outside and independent information.

Q. 13. Suppose that statement furnished by Schardt as the basis

of the examination, had been false, could it or not have been shown to be false, by an examination such as you would understand could be made and is usually made in banks like that?

A. Yes, sir; it could have been shown to be false.

Q. 14. When the trial balance taken from the individual ledger does not agree with the balance shown to be due individual depositors on the general ledger, or the daily balance book, what is then done to correct it, and is there any way in which it can be corrected?

A. The work has to be gone over again until the error is found.

Q. 15. In order to keep the accounts correct in the bank, is it necessary that the general ledgers and the individual ledgers should at all times agree?

A. Yes, sir.

Q. 16. If at any time a trial balance had been taken from the individual books in the Mechanics' bank and compared with the amount shown to be due individual depositors on the books kept by Schardt, would it or not have shown a discrepancy—that is, at any time after Schardt falsified his books?

A. It would.

Q. 17. Would this or not have led at once to the detection of the falsity of Schardt's books?

A. It would.

Q. 18. At any time after Schardt had falsified his books, would or not a statement made by a finance committee to the effect that they had examined and verified Schardt's accounts, be true, if they had failed to get a trial balance from the individual ledgers and compared that with the amount shown to be due depositors on the books kept by Schardt?

A. It would not.

Q. 19. Is there any other way in which the accounts of
90 Schardt could have been verified or properly examined?

A. There was not.

Q. 20. How would it be possible for bank officers or committees to know the condition of the bank without taking a trial balance from the individual ledger?

A. They could not know the right condition of the bank.

Q. 21. Could they or not have known whether the accounts kept by Schardt were correct?

A. They could not.

ALLEN B. FISHER.

Endorsed: Filed May 15th, 1895. H. M. Doak, clerk, by E. L. Doak, D. C.

Deposition of John A. McEwen, Taken by the Defendant.

Q. 1. Were you a member of the executive committee of the complainant bank during the years 1891 and 1892?

A. Yes, sir.

Q. 2. Did you take an active part in the examination of the accounts of the teller, Schardt, during those years?

A. Yes, sir; I was there generally at every examination.

Q. 3. How were these examinations made?

A. They were made by a memorandum of all the papers carried from time to time, and checking those papers, and examining the securities on the papers, to see that they corresponded with the statement.

Q. 4. Who made the statement or memorandum with which you compared the securities?

A. That was made either by Mr. Schardt or his assistant at Mr. Schardt's dictation. Mr. Sykes was the cashier during those years and I think he furnished us the statement. Mr. Sykes was an expert book-keeper and that was the reason he was cashier.

Q. 5. Did you examine any of the books themselves kept by Schardt, or did you take the statement furnished by the cashier?

A. I took the statement furnished by the cashier. I was never there except a few minutes each day. Mr. Eatherly was there most of the time and I relied mostly upon his knowledge of the running of the bank.

Q. 6. Please state who composed the executive committee for the years 1891 and 1892.

91 A. The executive committee for 1891 was composed of F. O. Beasley, J. B. Richardson, J. M. Eatherly, W. T. Smith and myself. For the year 1892, it was composed of John Woodward, W. A. Lannom, Chas. Sykes, J. M. Eatherly and myself.

Q. 7. Is Mr. Lannom dead?

A. Yes, sir.

Q. 8. Do you remember whether he was present during the meetings of the executive committee at which examinations of accounts were made during the year 1892?

A. Yes, sir; he was at some of the meetings.

Q. 9. In making examinations of the bank were the examinations directed to ascertaining whether or not the employés of the bank were defaulters or was it more particularly directed to an examination of the papers carried by the bank?

A. It was done for the protection of the bank, to see that the credits were correct, and that the collaterals were of proper value, and also to see that all papers entrusted to the bank were there.

Q. 10. During the years '91 and '92, were trial balances from the individual ledgers ever taken off?

A. That was left to Mr. Sykes. He was cashier of the bank, and being an expert book-keeper, I suppose he attended to that.

Q. 11. You never made inquiry to ascertain whether that was being done or not?

A. No, sir.

Q. 12. Was Mr. W. T. Smith present at these examinations?

A. I don't think he was.

Q. 13. Do you remember whether Judge Woodward was present in '92?

A. I think he was at one or two meetings, but we asked his advice on numerous occasions.

Q. 14. When did he sell his stock and sever his connection with the bank?

A. A short time previous to the closing up of the bank.

JOHN A. McEWEN.

Cross-examination of JOHN A. McEWEN:

Q. 15. Were there always present of the finance committee at least three of the members or more?

A. Yes, sir.

Q. 16. I understand that the finance committee in addition to its daily meetings looking after discounts, etc., also met quarterly to make examinations; am I correct in this?

92 A. Yes, sir.

Q. 17. Please state how these quarterly examinations were made and had.

A. We counted all the money or things that represented money, such as cash tickets, checks on other banks, deposits in other banks, and compared this with the statement furnished us by the cashier or teller. Then we took possession of all notes, bills, time or demand loans or other papers showing an indebtedness to the bank, as well as collaterals attached, and did our best to ascertain the condition of the paper and the value of the collaterals. We compared this with the statement furnished by the cashier or teller of what should be in the bank of these kinds of papers, and also compared it with the daily balance book. As we had seen all notes or bills which had been discounted by the bank and these had been entered on the daily balance book, we would sometimes go back to it. We always took the cashier or teller's written statement of the deposit account; we hardly ever examined original entries of deposits, but accepted this statement as making a full and fair exhibit of these. We could not have examined original entries. There were several hundred depositors, and a great many small accounts with individuals; it would have taken all our time to have done this, and but few, if any of us, were book keepers or accountants; we had to rely upon the honesty of the cashier for this. We did our best to ascertain the exact condition of the bank at the end of each quarter. The finance committee was the discount committee, and all paper approved by the committee was recognized by the committee at the quarterly examination. If we did not remember it we appealed to this book of original entries on the ticket. These quarterly examinations were of the same kind and character which all the banks of Nashville made, as we understood.

Q. 18. When did Schardt become cashier?

A. In January, 1893.

Q. 19. How was the attendance of the finance committee at the quarterly meeting?

A. Generally pretty full; we never commenced the examination until a majority or at least three members were present.

Q. 20. Was there a daily balance book kept, and were daily balances taken off?

A. Yes, sir.

Q. 21. What officers came before the committee and made such reports as were required?

A. The cashier, Mr. Sykes, down to some time in January,
93 1893. On the 25th of March, 1893, the Commercial national bank closed its doors, and on the following Monday, the 27th, we closed temporarily, and we opened again in the latter part of March, 1893. There was a run made on all the banks on the 27th of March, and we took advantage of a sixty-day clause in our savings-bank charter, after remaining open a few minutes on the 27th. Rumors prevailed derogatory to the officers of the Commercial bank, and when we had borrowed $50,000, largely on the credit of the directors, we opened again in the latter part of March and brought into the bank an expert accountant, to take a full and complete account of everything, which began pretty soon to develop that some one or more of our officers had not been honest, and on the 17th of April we became satisfied that the bank's loss had been so great that it could not stay open longer, and made an assignment.

Q. 22. Was there or not at any time a failure to have the examination of the bank's affairs and condition quarterly?

A. No, sir.

Q. 23. Were there any other examinations of the bank's condition, and the officers' books?

A. Yes, sir; every July and January of each year the directors and finance committee made an examination into the affairs of the bank to ascertain its condition financially with a view to ascertaining the ability of the bank to pay a dividend. These examinations of the directors and finance committee were as thorough as we could make them.

Q. 24. When did John Schardt die?

A. April 17th, 1893, before we had ascertained the full amount of his embezzlement of the money of the bank, but when we had learned sufficiently to believe that he was involved to some extent.

Q. 25. Did you know the general character of John Schardt in Nashville, for honesty and integrity and truthfulness?

A. I did. I knew him from his boyhood.

Q. 26. Was it good or bad?

A. It was good—first-class. No young man had a better reputation for honesty or integrity or industry. He was attentive to his business, never losing a day for several years, and had the reputation of being a pious and religious man, as well as very economical, and lived modestly and quietly.

Explanation.—By cashier and teller's report, I mean the
94 report or statement made out by our teller, who was also one of our book-keepers. This report came through the hands of our cashier, approved by him, and was known to our committee as the cashier's report. The teller's work was merely clerical, the responsibility and accuracy of these reports or statements rested in our eyes, entirely upon our cashier, Mr. Sykes, in whom we had confidence.

JNO. A. McEWEN.

(Endorsed:) Filed May 15, 1895. H. M. Doak, clerk.

Deposition of J. B. Richardson, Taken by the Defendant.

Q. 1. Were you a member of the executive committee of complainant bank for the year 1891?

A. I was.

Q. 2. Were you present at the examinations made by the committee of the accounts of John Schardt during the year 1891?

A. I couldn't say positively whether I was or not.

Q. 3. Do you remember of ever being present prior to January, 1893, at any of the examinations of his accounts?

A. I was frequently present at the examinations of the accounts of the bank.

Q. 4. What do you mean by the accounts of the bank?

A. I mean the securities, stocks, bonds, individual accounts of the employés of the bank, and all accounts kept in the bank.

Q. 5. How did you examine the accounts of Schardt while he was teller?

A. The cash was generally counted; cash tickets examined, and a general balance made.

Q. 6. How did you examine the account on his book showing the amount due individual depositors?

A. There was a daily balance-sheet which showed all the assets and liabilities of the bank, including the amount due individual depositors.

Q. 7. Did you take this daily balance-sheet as a basis off examination?

A. It was generally conceded as a basis of the status off the business.

Q. 8. How did you examine the amount shown to be due individual depositors on this daily balance-sheet?

A. I don't remember of the committee ever having gone through the books and itemizing the individual deposits. This ballance-sheet was taken as a true representation of those deposits.

95 Q. 9. Then coming back to my question—how did you examine the accounts of Schardt?

A. Schardt was teller at the time, and it was not considered absolutely essential by me or by the committee to go minutely into the general books outside of an examination of his cash account, and all items that were paid out.

Q. 10. Then do I understand you to say that you accepted the amount shown on the daily balance-sheet to be due individual depositors to be correct without further examination?

A. No; I can't say that. The books were frequently gone over by the committee in a general way, and anything they might have come across that would have been unsound would have necessarily aroused suspicion.

Q. 11. Were you ever present when the committee went over the general books of the bank prior to January, 1893?

A. I can't call to mind any specific time, but I was very actively

engaged in the affairs of the bank at this time, and frequently met the committee and advised with them, and even went through the books with them.

Q. 12. Please state concisely how you examined and verified the amount on the daily balance-sheet shown to be due individual depositors?

A. I have sufficiently answered that question before.

Q. 13. Has anything wrong ever been discovered with the individual ledgers showing the accounts of the depositors in detail?

A. I understand that the expert examiner, Mr. McEwen, states that there was nothing wrong with the individual ledgers.

Q. 14. Did your committee at any time ask for or see a trial balance from the individual ledgers?

A. My recollection is they did.

Q. 15. With reference to what date are you now speaking?

A. 1891.

Q. 16. Did you compare this trial balance from the individual ledgers with the amount shown to be due individual depositors on the general ledger?

A. I don't remember, but I suppose it was.

Q. 17. Have you any recollection upon this point?

A. No; I couldn't state positively.

Q. 18. Do you remember assisting the executive committee during the year 1891 in making an examination of Schardt's accounts?

A. I was very actively interested in the bank and at-
96 tended the meetings of the board of directors and executive committee very promptly, and it is my impression that I was present at times when the examination was going on in 1891.

Q. 19. Did you assist the committee in making these examinations of Schardt's accounts?

A. I can't say that I did assist them in every examination; but I am under the impression that I did in one or two instances.

Q. 20. Do you remember of being present and assisting in the examination made in December, 1891?

A. I do not. I may have been there, but I can't call it to mind.

Q. 21. Do you remember during the year of 1891 of having, at any time, counted the notes on hand and compared them with the note register?

A. I answer that question the same as above.

Q. 22. My question was with reference to the one branch of the examination, viz., with respect to counting the notes and comparing them with the note register?

A. I don't remember whether I was there or not at all times.

Q. 23. As I understand you, you cannot recall whether this was done or not?

A. It was done; but I cannot name the exact time when I was present. I am satisfied that I was present at the examinations more than one time.

Cross-examination of J. B. RICHARDSON:

Q. 1. Who constituted the finance committee in 1891?

A. J. M. Eatherly, Jno. A. McEwen, Wm. T. Smith, and F. O. Beasley, and I.

Q. 2. How frequently did you attend?

A. I am unable to state the exact times that I was absent; I was very much interested in the bank, and gave it a great deal of my time and attention. For some purposes, such as passing upon paper tendered for discount, the finance committee met almost daily. These are the meetings that I did not attend daily. My best recollection is that I attended the quarterly meetings uniformly, though one may have occurred when I was North buying goods, though I have now no recollection that such was the case.

Q. 3. Now, please state in what mode and to what extent examinations were made by this committee quarterly?

97 A. At these meetings there was always present, either all of the committee, or if not all, certainly three of us were present before we commenced the examination. We always counted the cash, and cash items, all notes, time or demand loans, bills and every paper due the bank was produced and examined, credits on the back of each taken off--all collaterals examined and estimated values put upon the collaterals, all aggregated and compared with the daily trial balance book. The daily balance of individual deposits and certified checks and bills payable as shown on the daily balance-sheet as exhibited by the cashier were examined. We did not go to original entries in the individual ledger, but accepted the statement in writing of the cashier for this. To have gone to original items and added up columns would have required an enormous expense, and much more time than could have been given it by directors or its committees, and it is not the custom or habit of committees to examine original items and entries, I understand, in this respect, but to accept the written statements of the cashier as correct. In addition to this we individually would, at times, go into the bank and look over the individual ledger in a general way as well as the general ledger. I did this and have seen others do it. In addition to this, the cashier would make semi-annual reports to the directors, which were examined. These reports accorded with the results of the quarterly reports, and were passed on by the board of directors. These reports related to the general condition of the bank showing its financial status and what had been made, and what had been lost during the preceding six months, and showed in general detail, the facts upon which such a result was obtained. It purported to be a complete report in every respect, and upon this depended the ability of the bank to declare and pay a dividend or not.

Q. 4. Did you know the reputation of John Schardt for honesty and integrity?

A. I did.

Q. 5. Was it good or bad?

A. Good, excellent; was regarded as one of the best young men

in Nashville, and was the most attentive man to his business I ever knew.

Endorsed: Filed May 15, '95. H. M. Doak, clerk.

Deposition of Theo. Cooley, Taken by Defendant.

Q. 1. State your age, residence and occupation.

98 A. I am fifty-two years of age, live in Nashville, Tenn., and am the general agent of the defendant company at Nashville, Tenn.

Q. 2. How long have you been representing the guarantee company?

A. Twelve years.

Q. 3. Did the defendant company at any time cancel its bond on John Schardt, while he was cashier of the complainant company, if so, when, and for what reason?

A. Yes, sir; the company did cancel its bond through me as its agent, the Saturday before the bank assigned on Monday. The cause which led to this action was that I had ascertained that John Schardt had been speculating in futures, and I so reported to the bank when the bond was canceled.

Q. 4. Does or not the company bond persons holding a fiduciary position who speculate?

A. No, sir.

Q. 5. Why not?

A. Because we have found by experience that no man who handles trust funds and speculates in futures is a safe risk.

Q. 6. It is a material inquiry or fact to be known by the guarantee company as to whether or not the applicant for a bond has been speculating?

A. Yes, sir; it is a material fact to be known, and one which the company always requires to be answered before issuing the bond.

Q. 7. If the fact is disclosed that the applicant is or has been speculating, does the company issue a bond upon him?

A. It does not, unless the applicant gives satisfactory assurances that he has ceased to do so, and the company believes he will not do so in the future.

Q. 8. How long has this been the custom of the company?

A. Ever since I have been connected with it. How much longer I do not know.

Q. 9. Did you know or hear of Schardt's speculations prior to the time mentioned above when you received such information?

A. I did not.

Q. 10. Have all matters pertaining to the issuance of the bonds upon Schardt in favor of the complainant passed through your hands as the representative of the company?

A. They have so far as I know.

Q. 11. Is it or not a part of your duties to gather information

99 concerning applicants for bonds and about persons already bonded in the defendant company, in this part of the country?

A. Yes, sir.

Q. 12. Do you transmit such information to the home office of the company?

A. I do.

Q. 13. If the company had received any information with respect to Schardt's speculations, or other information unfavorable to him, would you have been advised of the fact by the company?

A. I would, as that is the usual method of doing business.

Q. 14. Have you ever had any experience in a bank; if so, how much?

A. Before I became the representative of the defendant company, I had occupied several positions in a bank, the last being that of cashier.

Q. 15. Does the company or not, before renewing a bond upon an employé in a bank, require the bank to certify that the applicant's books and accounts have been examined and verified?

A. It does.

Q. 16. Is this a material fact for the company to know?

A. It is material, because the company never renews the bond of an employé whose accounts and books have not been examined and found correct.

Q. 17. Why is this so?

A. The principal reason is that the company is not willing to remain on the bond of any one whose books and accounts are not examined at least once a year, because after that time it is so very difficult to ascertain accurately whether there has been any default, and unless the accounts and books show that the applicant has been honest, the company does not want to continue upon his bond, but deems it an improper risk for it to carry and deems it best for the employer to know whether or not his employé is honest.

Q. 18. Were such statements made by the complainant bank at the end of each year during the currency of the bond upon Schardt as teller in the bank?

A. They were.

Q. 19. Was the renewal issued upon the faith of the statements being true?

A. Certainly so. If the bank certified that the accounts had been verified, or had certified that they had been found incorrect, the company would not have renewed his bond.

Q. 20. What do you understand is meant by saying that
100 the books and accounts of a person have been examined and verified?

A. I understand it to mean that the books and accounts have been examined in the usual manner of examining such books, and that they have then been verified by such evidence as is usually applied to the verification of similar accounts or books by the persons who are charged with making such examinations and verifications.

Q. 21. Can such verification ever be made by accepting the statement of the person whose books and accounts are under examination? Either as to the whole or any part of the same?

A. Certainly not.

Q. 22. Did you tender to J. J. Prior, assignee, the premium received by the company for the issuance of the bond upon Schardt as cashier of the complainant bank?

A. I did.

Q. 23. Prior to the assignment of the bank did you ever hear or know of any defalcation or wrong-doing, upon the part of any employé of the complainant bank?

A. No, sir; except as above stated with respect to Schardt speculating, which I found out a few days before the bank assigned.

THEO. COOLEY.

Q. 23. Is it a material fact to be known before bonding an applicant, whether or not there has been a shortage or defalcation in the position for which the bond is asked?

A. It is very material.

Q. 24. Why is it material?

A. Because the company before issuing the bond desires to know whether or not there are proper safeguards thrown around the position to prevent a defalcation; whether or not the officers or employers have exercised due diligence in preventing or detecting a defalcation; and whether or not experience has shown the place to be a proper risk for the company to take, or whether or not they are competent to exercise a proper supervision over the employés of the institution with which they are connected.

Q. 25. Did Schardt leave any estate when he died?

A. No.

Q. 26. What did he do with the money he abstracted from the bank?

A. It is generally understood that he lost it speculating in produce and stocks.

THEO. C.

101 Cross-examination of THEO. COOLEY:

Q. 1. What day of the month did you make the alleged cancellation of the bond and what bond?

A. I think it was the 15th of April, 1893, and Schardt's bond as cashier.

Q. 2. How long after this before Schardt died?

A. I think he died on the Monday night following the Saturday morning that we went off of his bond.

Q. 3. When did you tender the money to Pryor, assignee?

A. December 28th, 1893.

Q. 4. Did you for and on behalf of defendant company keep a detective or other person or persons to look after the habits of such persons as bonds had been given for?

A. We had no detective in this case. I got information from outside parties regarding Mr. Schardt. In the performance of my duties I sometimes get detectives to follow the habits of parties we have bonded.

Q. 5. Have you resided in this community all your life?

A. Yes, sir.

Q. 6. Have you stated your experience as a bank officer? Now, does the keeper of the individual or general ledger of depositors have the handling of money or are they simply book-keepers?

A. They are simply book-keepers and are not expected to handle the funds of the bank.

Q. 7. How long have you had charge of the defendant corporation's affairs in Nashville, and in what position?

A. Since 1882, as near as I can remember; as its general agent.

Q. 8. Has the company a local or branch board located in Nashville?

A. Yes, sir.

THEO. COOLEY.

Endorsed: Filed May 15, '93. H. M. Doak, clerk, by E. L. Doak, D. C.

102 The following replication was filed:

MECHANICS' SAVINGS BANK AND TRUST COMPANY
vs.
THE GUARANTEE COMPANY OF NORTH AMERICA, to Use, etc.

The complainant comes and denies the truth of the allegation of the answer of the defendant filed herein, and he also reaffirms the truth of the matters set out in his original bill of complaint in this cause and declares that it is able and ready to prove to the court all the allegations of its original bill, complainant also denies the sufficiency of the matter contained in the answer of defendant, and now joins issue with the defendant, as to the truth of all issues of fact set forth and alleged in said original bill and said answer.

EDWARD H. EAST, *Solicitor.*

Endorsed: Filed May 15th, 1895. H. M. Doak, clerk.

The following stipulation was filed:

MECHANICS' SAVINGS BANK AND TRUST COMPANY
vs.
THE GUARANTEE COMPANY OF NORTH AMERICA.

It is stipulated in this case that should any court hold that this case on its removal to Federal court from the State court, *that* it should be put upon the law docket a jury is expressly waived, and that the same may be heard and decided by the court without the intervention of a jury and upon its merits, without regard to the form of the pleading, and that the issues made in the pleadings, as they stand shall constitute the issues to be tried by the court, and also that all captions and certificates to depositions are waived, as well as the fact that some depositions are not subscribed and sworn to.

GRANBERRY & MARKS,
Solicitors for Defendant, Guarantee Company.

103 Endorsed: Filed May 15th, 1894. H. M. Doak, clerk, by E. L. Doak, dep'y clerk.

Pending in the United States Circuit Court for the Middle District of Tennessee.

MECHANICS' SAVINGS BANK AND TRUST CO., for the Use of James J. Pryor, Assignee,
vs.
GUARANTEE COMPANY OF NORTH AMERICA ET ALS. } In Equity.

In this cause it is stipulated that the following are facts and may be used by the defendant company as evidence on its behalf, as fully and completely as if such facts had been proven in the usual and customary way:

The defendant is a corporation organized under the laws of the Dominion of Canada for the purpose of furnishing bonds of suretyship and guarantee; and has been engaged in business in Canada and the United States since 1872.

Said company issued the bond in suit on John Schardt as teller and collector to the complainant bank in January, 1888, and the same was kept in force by renewal receipts until January, 1893.

The bond in suit on said Schardt as cashier was issued to said bank in January, 1893, and remained in force until the bank assigned and until the death of said Schardt.

In the teller's bond a statement is referred to as having been delivered to the defendant company by the bank; said statement was in fact delivered to the company before the issuance of the bond and is signed by C. W. Peden, as cashier, dated in Jan., 1888, and the teller's bond was issued to said bank upon the receipt of said statement. Which said statement is as follows:

Proposal No. —. Amount, $—.

The Guarantee Company of North America.

(Established 1872.)

Head office, Montreal.

104 SIR: An application having been made to this company to issue bond of security for Mr. John Schardt, of Nashville, Tenn., in the service of your bank, to the amount of $10,000.00, the company, in order to decide upon his application for said bond, desires to have answers to the following questions, as fully and definitely as possible on behalf of the said bank. The directors trust to the co-operation of employers in giving every information in their power, and any points known to the employer and not brought out in the questions below, they earnestly ask the employer to communicate, so that any information affecting the applicant's past or present history, however slight, may be thoroughly sifted, to the interest and protection of all concerned.

I am, sir, yours obediently,

EDWARD RAWLINGS,
Managing Director.

To —— ——.

Questions.

Q. 1. If a new employé, please say if the applicant is personally known to you, or to any of the principals in your bank? And if so, are his antecedents, so far as known, in all respects correct and such as to entitle him to the confidence of both this bank and this company?

A. Is personally known to the principals of the bank. It is.

Q. 2. If not previously known as above, please say by whom he has been introduced or recommended to you or how did he become known to you?

A. * * *

Q. 3. If an old employé, please state about how long he has been in your service, whether he has on all occasions and in all respects performed the duties of his situation, and conducted himself to your satisfaction? Or has any irregularity occurred or has his conduct at any time been such as to incur your censure, if so, please state when and its nature.

A. About six months. Has given satisfaction.

Q. 4. Has he been in any other capacity in your service, and if so, in what position?

A. Assistant book-keeper.

Q. 5. Has the applicant to your knowledge been—have you heard of his having been—a defaulter to any other company or person? Has he been irregular in his habits at any time, or have you ever heard of any charge or either of these nature being made against him? Do you know anything of his previous employment and whether he has ever been dismissed or suspended, and if so, for what reason?

A. Has not. Has not. Has never been dismissed or suspended that we know of.

Q. 6. In what position or capacity do you now require this security from him and from what date do you wish this guarantee to commence?

A. Teller and collector. From January 15, 1888.

Q. 7. When was the last inspection of the office at which he is stationed, made?

A. Dec. 24, 1887.

Q. 8. What is your custom in regard to the frequency of inspections? Are they at stated periods, or irregular, and what is the longest time allowed to elapse between inspections?

A. Every quarter.

Q. 9. Has the bank a duly appointed and authorized inspector, or inspectors? If not, by whom are the inspections made?

A. The finance committee.

Q. 10. Has the bank printed rules, regulations and by-laws for the guidance of its employés, and has a copy been handed, or will one be handed to this employé?

A. It has.

Q. 11. Have you ever sustained loss at the hands of this or any

other person holding this situation? If so, state to what amount and in what manner.

A. Have not.

Q. 12. The salary paid to him, and how it will be paid?

A. Twelve hundred dollars. Monthly.

Q. 13. If other allowance will be made to him, state particulars.

A. No other allowance.

Q. 14. Whether such allowance or salary is subject to any deduction? If so, state nature and extent of them.

A. Is not.

Q. 15. Is he at present engaged in or will he be allowed to undertake any other business or occupation?

A. Will not.

Q. 16. Who will pay the premium on this guarantee?

A. The bank.

Q. 17. Do you hold or will you require any further security from the applicant than this? If so, what is its nature and amount? Have you hitherto held other security for the applicant? If so, what is the cause for change in this?

A. Will not.

Q. 18. In the event of the employé filling the post of
106 teller—how often and by what officer will the teller's cash be checked and counted?

A. By the finance committee; quarterly.

Q. 19. If manager, or cashier at head office, or branch, please say under what other officer's joint custody the treasury will be.

A. * * *

Q. 20. If at a branch, please state what staff of officers is maintained there, in addition to the applicant?

A. * * *

I hereby declare that the answers and representations above made are true, and that I am not aware of any matter or thing affecting the character or reputation of the applicant, which should create any doubt as to his reliability or trustworthiness.

Dated at Nashville, Tenn., this 21st day of January, 1888.

Signature: C. W. PEDEN,
Cashier, on Behalf of Bank.

Employer's proposal.
Bankers.

Endorsed on margin: The bond of this company are accepted by nearly all public corporations in Canada and the United States in lieu of private suretyship.

Endorsed: Edward Rawlings, Esq., managing director, the Guarantee Company of North America, Montreal.

Endorsed: Filed July 11, 1895. H. M. Doak, clerk, by E. L. Doak, deputy clerk.

Said teller's bond was renewed each year to January, 1893, and in each year before the bond was renewed the defendant company

furnished the complainant bank with a blank form to be filled out which provided as follows:

"It is necessary before the bond can be renewed that you obtain the certificate on the back hereof by your president or cashier and on its return with remittance of the premium, the renewal can be immediately effected."

The certificate on the back was filled up and signed by the cashier and among other things it stated that the accounts of said teller, Schardt, had been examined and verified by the finance committee of said bank, and the bond was not renewed any year until this certificate had been made out and delivered to the defendant company.

The defendant company executed and delivered said cashier's bond to said bank, to begin from Jan. 1, 1893, but was issued after the 10, 1893, and the statement referred to therein as bearing
107 date January 10, 1893, No. 154,806, and signed by Lewis T. Baxter, president, and designated as employer's guarantee. Proposal was in fact executed and delivered to the defendant company before the issuance of said bond, and was as follows:

The following proposal was filed:

Proposal No. —. Amount, $20,000.00.

The Guarantee Company of North America.

(Established 1872.)

Head office, Montreal.

DEAR SIR: Mr. John Schardt having applied to this company for the issue of a bond of security to the amount of $20,000.00 upon his behalf as cashier in the service of your bank, the following questions relative to his employment and other matters are respectfully submitted for reply on behalf of the bank. In order that the directors may be fully informed in deciding upon the proposal, it is desired that the answers be as complete and definite as possible for mutual protection.

Yours respectfully, EDWARD RAWLINGS.

To Lewis T. Baxter, p't, managing director, Mechanics' Savings Bank and T. Co., Nashville, Tennessee.

Q. 1. Full title and address of bank?

—. Mechanics' Savings Bank & Trust Company, Nashville, Tenn. Bank commenced business, Dec. 3, 1885. Paid-up capital, $50,000.00. Assets, $243,904.64. Surplus, over capital and liabilities, $27,116.63; as per statement Dec. 31, 1893.

Q. 2. If a new employé, by whom was the applicant introduced, or how did he become known to you? If hitherto in continuous service, for how long, in what capacities, and has he uniformly performed his duties faithfully and satisfactorily?

A. Applicant began service in this bank six years ago as collector--cl'k, and has since been advanced to bank's teller and now cashier.

Q. 3. Has he ever been in arrears or default in the bank's service, or, as far as you have heard, in any previous employment?

A. No.

Q. 4. Have you known or heard anything unfavorable as to his habits or associations, past or present?

A. No.

108 Q. —. Or of any matters concerning him about which you deem it advisable for the company to make inquiry?

A. No.

Q. 5. Is he to your knowledge pecuniarily embarrassed or insolvent? Or is he in any way indebted to the bank?

—. —.

Q. 6. Is he now or about to be engaged in any other business or employment than in the bank's services?

A. No.

Q. 7. Applicant's position or capacity for which this bond is required?

A. Cashier.

Q. 8. Amount of his salary or other emoluments if any?

A. $2,000.00 per annum.

Q. 9. Amount or bond hereby required, from what date to commence and by whom premium will be paid?

A. $20,000.00 to date from Jan. 1, 1893. Premium payable by bank.

Q. 10. What further security, if any, will be held or required from applicant?

A. None.

Q. 11. Have you hitherto held other security from applicant? If so, why discontinued or changed to this?

A. Formerly teller and general book-keeper in this bank; elected cashier at annual meeting January 1, 1893.

Q. 12. Has there been any fault in the bank by any employé in applicant's position?

A. No.

Q. 13. When were applicant's books and accounts (including cash, securities and vouchers, if any) last examined, and by whom?

A. December 31, 1892, by finance committe (were they found correct) of bank and found correct.

Q. 14. In case of applicant handling cash or securities, how often will the same be examined and compared with the books, accounts and vouchers, and by whom?

A. Not less than quarterly, and often monthly, by finance committee.

Q. 15. In case of applicant acting as teller: (*a*) Will he be required to balance his cash daily, and report same to president or cashier? (*b*) And will a record of same be kept?

A. * * *

Q. 16. Will applicant handle funds or securities not subject to a routine check, or periodical examination? If so, please describe their nature?

A. No.

Q. 17. Do you periodically balance depositors' pass books,
109 or render them statements of their balance, and about how often?

A. Yes

Q. 18. If employés in the bank consist of six or less besides cashier, please state their respective positions?

A. President, cashier, teller, book-keeper and collector and clerk.

Q. 19. At what date was the bank last examined by a national or State official? And was the result satisfactory to the department?

A. * * *

The above answers and representations are true to the best of my knowledge and belief.

Dated Jan. 10, 1894.

Signature: LEWIS T. BAXTER,
Official title: *President.*

Employer's form.
Banks.

Endorsed: Filed July 11, 1894. H. M. Doak, clerk, by E. L. Doak, deputy clerk.

That the bank closed its doors and made an assignment for the equal and *pro rata* benefit of all its creditors to Jas. J. Pryor, assignee, on the 17th day of April, 1893, and he has accepted the trust.

That notice was given to the defendant according to requirements of bond for cashier and teller on the 20th day of April, 1893, and proof of loss made to said company, according to the terms of said bond.

That no exceptions are taken to the notice or proof of loss in respect to the bond as cashier, and none will be urged upon the court at the trial. It is further agreed that this suit was commenced April 9, 1894.

That before the first day of May, 1893, Jas. J. Pryor, assignee, by written request made to the company through its general agent, Theo. Cooley, at Nashville, to assist either personally or by expert in the examination of the accounts of said Schardt, and the same was refused by letter of May 1, 1893.

Either party may use on the trial such parts of the applications for the two bonds as may be deemed necessary.

Nashville, Tennessee, February 28, 1895.

E. H. EAST,
Solicitor for Complainant.
GRANBERRY & MARKS,
Solicitors for Defendant.

110 Endorsed: Stipulations of counsel. Filed May 15, 1895. H. M. Doak, clerk.

An opinion of the court was filed for which see Federal Reporter

The following final decree was made and entered, viz:

This cause was heard at a previous day of the term, and the court took an advertisement to this day. The cause having been heard upon the original bill, answer, stipulations and proof, as well as upon argument of counsel. One of the stipulations is as follows:

"It is stipulated and agreed in this case that should any court that hold this case, on its removal to the Federal court from the State court, should be put upon the law docket, a jury is expressly waived, and the same shall be heard and decided by the court without the intervention of a jury, and upon its merits, without regard to the form of the pleadings, and that the issues made in the pleadings, as they stand, shall constitute the issues to be tried by the court; also that all captions and certificates to depositions are waived, as well as the fact that some of the depositions are not subscribed or sworn to."

The court is of opinion and adjudges and decrees as follows:

That Schardt has been a defaulter within the sense of his two bonds; that in the years 1890 and 1891 the amount of his embezzlement from the bank was comparatively small and has been paid out of assets and collections theretofore transferred to the bank by Schardt to secure it, just before his death; that the embezzlements for the year commencing September 1st, 1890, to January 16th, 1891, amounted in the aggregate to $5,879.34 with interest to April 15th, 1893, of $890.04, makes $6,769.38. From January 16th, 1891, to January 1st, 1892, $22,290.00, interest to April 15th, 1893, of $2,299.08, added, makes $24,589.08. From January 1st, 1892, to January 1st, 1893, $50,649.90, with interest to April 15th, 1893, of $2,086.27, added, makes $52,736.17; and these from January 1st, 1893, to April 17th, 1893, during the currency of his said bond as cashier, to $22,964.17, which, with interest to April 15th, 1893, of $164.52, makes the sum of $23,128.69, in the aggregate; and that the total amount of said embezzlements during all the years mentioned in both positions, was of principal, $101,783.41, which, with interest to April 15th, 1893, of $5,439.91 added, makes an aggregate of $107,223.36.

111 It appearing that Schardt had assigned to the bank to indemnify it against loss, 2 lots of land assigned to J. B. Richardson and life-insurance policies amounting to $80,000.00, some of which policies have been paid to the assignee without suit, and others are now in litigation in this court, or pending on appeal or writ of error to the appellate court of this circuit, held at Cincinnati, the court adjudges upon inspection of said guaranty bonds, their terms and various conditions, and the proof submitted, that the bank has complied with the same and all its undertakings thereunder, substantially; and that said Schardt embezzled and fraudulently appropriated the moneys of the bank while he filled said two positions, to the amounts named; and that interest should be calculated upon said sums from the end of his respective terms.

The court, after considering the various and numerous defenses set up by defendant company, why a recovery should not be had upon either of said bonds, or both, in favor of complainant, is

pleased to disallow each and all of said defenses, and to order, adjudge and decree that complainant have its decree or judgment against the defendant, The Guarantee Company, upon each of said bonds with interest from the time the same should have been paid according to the terms of said bonds, and for the costs.

That complainant have judgment on the teller's and collector's bond for the sum of ten thousand dollars principal and the further sum of seven hundred and seventy dollars, being interest at six per cent. from 9th of April, 1894, to July 1st, 1895; and that complainant have judgment on the cashier's bond against defendant guarantee company for the sum of twenty thousand dollars principal and the further sum of $1,540.00 interest thereon from April 9th, 1894, to July 1st, 1895, making in the aggregate of principal and interest on both bonds the sum of thirty-two thousand three hundred and ten dollars ($32,310.00) with interest thereon until paid and the costs of this suit.

And the court orders and decrees that the liability of the defendant, The Guarantee Company, is secondary to that of John Schardt's estate; and that the bank or its assignee shall account for all collections realized on assets or collaterals turned over to the bank by said Schardt to reimburse it against his shortage, which it has collected, or with due diligence may collect hereafter; and for his fitness, and for convenience, H. M. Doak, is appointed master
112 commissioner to report the same to the next term of this court; and the court orders that the same be applied to the shortage of said Schardt in the order in which the same occurred and in the meantime no execution will issue against defendants for the same, but only for the costs; and the court orders that this cause may be continued upon the docket of this court, for the purpose only of making any orders necessary to apply all collections from assets of Schardt, held as collateral, in exoneration, to that extent, of the defendant company and of substituting the defendant to the rights of the bank, in case the recovery herein is collected or paid and any of said assets remain above the amount necessary to satisfy the shortage. But the case is retained for no other purpose, and the decree against defendant company is final as fixing its liability on the bonds to make good the shortage, whatever that may be. This decree is entered in lieu of one entered at a former day of the term and the decree formerly entered is hereby vacated.

The following petition was then filed, viz:

In the United States Circuit Court for the Middle District of Tennessee. Equity Docket.

MECHANICS' SAVINGS BANK AND TRUST COMPANY }
vs.
GUARANTEE COMPANY OF NORTH AMERICA ET AL. }

To the Honorable C. D. Clark, judge of the United States circuit court for the middle district of Tennessee:

Your petitioner, The Guarantee Company of North America, respectfully represents and makes known unto your honor the following:

This cause was originated by suit in the chancery court at Nashville, Tennessee, by the assignee of the plaintiff, to recover from petitioner the amount of two bonds upon its teller and cashier, respectively under which bonds petitioner agreed, upon certain terms and conditions, to indemnify the plaintiff's assignor against losses arising from the fraudulent conduct of the employé. The
113 cause was determined by your honor at the April term of the court, 1895, holding petitioner liable to the full amount of each bond and directing a reference to a special commissioner to report the amount of assets in the hands of the assignee to be first applied to the default of the bonded employee before the liability of the petitioner.

The cause was appealed to the circuit court of appeals for the sixth circuit, and was there heard and decided October 5th, 1896, that court affirming the decree of your honor; and thereafter, in December, 1897, a petition for a writ of certiorari was filed in the Supreme Court of the United States by petitioner which writ was granted and the cause was heard in that court at its October term, 1898, when the decree of the circuit court of appeals was reversed and set aside because it appeared that the decree entered by your honor was not a final decree from which an appeal would lie to the circuit court of appeals. Thereupon on the 10th day of June, 1899, the circuit court of appeals for the sixth circuit, in obedience to the command of the Supreme Court, set aside its former decree and remanded the cause to this court for further proceedings.

No decree has yet been entered in this cause in this court upon the mandate from the circuit court of appeals.

Petitioner further represents that, among other defences set up in its answer and sought to be maintained in the evidence, was that relating to the knowledge of the bank officials of the speculation and bucket-shop dealings of its bonded employé. It was shown by the petitioner that the president of the plaintiff bank learned in the summer or fall of 1892, that the bonded employé, Schardt, had been speculating and had been part owner of a bucket shop and in January, 1893, the president represented to petitioner that he had never heard of and had never known of anything unfavorable as to the habits and associations of the bonded employé, past or present. The plaintiff did not take the deposition of the president to contradict this evidence and no effort was made otherwise to contradict the same.

This defense was and is very material to the petitioner. While the case was being prepared every one having knowledge of facts relating to this defense was silent and only after the case had been appealed, and it was supposed that no new evidence could be introduced, did it come to the knowledge of petitioner that additional facts relating to this defense existed. The persons knowing such facts only disclosed them after the case had been tried by your honor.

114 Petitioner is now prepared to prove that both the president and chairman of the finance committee of the bank learned definitely of Schardt's bucket-shop interest in November or

December, 1892. That, at that time, Schardt still had an interest in a bucket shop and retained the same until March, 1893. Petitioner is now prepared to prove that Schardt, during all the year 1892, was speculating in more than one place in Nashville, Tennessee, that he constantly gave orders to employés of a bucket shop who came to the bank daily for such orders and that he telephoned orders for speculative deals from the telephone in the bank and made constant inquiries concerning the stock market over the bank's telephone.

Petitioner is prepared to prove that the chairman of the finance committee of the bank was, during the same time, speculating and had orders executed through Schardt and that he and Schardt were speculating in the same securities.

Petitioner is prepared to prove that in the fall of 1892, Kyle, who informed the cashier of *the* Schardt's connection with the brokerage concern, also informed the president of the same facts.

Petitioner is prepared to prove that the chairman of the finance committee of the bank knew that Schardt had been speculating during the year 1892 and he knew of this prior to December 31st, 1892.

Petitioner made diligent efforts to bring these facts to light while the evidence was being taken, but was unable to do so.

In view of the premises, petitioner prays that decree be entered reopening the cause for proof and that the plaintiff as well as the defendant company, be permitted to take additional evidence, during such time as the court may think reasonable. If the case shall be reopened, the additional evidence will disclose all facts necessary to enable the court to pronounce a final decree without the necessity of a reference, which has heretofore been ordered, and no longer time need be consumed in taking additional testimony than would be necessary under the reference.

Wherefore, etc.

WM. L. GRANBERY, *Solicitor.*

STATE OF TENNESSEE, }
Davidson County. }

Personally appeared before me, the undersigned, Theodore Cooley, and made oath in due form of law that he is the general
115 agent at Nashville of the above-named petitioner The Guarantee Company of North America and as such makes oath that the matters and things stated in the foregoing petition as of his own knowledge are true and those stated upon information he believes to be true.

THEODORE COOLEY.

Sworn to and subscribed before me this 27th day of June, 1899.

[SEAL.] WM. SMITH, JR.,
Notary Public.

The following opinion was handed down by the court, viz:

MECHANICS' SAVINGS' BANK & TRUST COMPANY
vs.
GUARANTEE COMPANY OF NORTH AMERICA.

The application to reopen this case, as now presented, is denied. The case stands just as it would have stood if this application had been made to the court after the former decree of this court and before the case was appealed. I think it is quite certain that no authority can be found to open a case where there is no stronger showing than is made in this application. It is true that the defendant avers that "petitioner made diligent efforts to bring these facts to light while the evidence was being taken, but was unable to do so." This is the averment, however, of a mere conclusion. The petition does not give the name of a single witness whom the petitioner now proposes to introduce, does not furnish the affidavit as to what such witness will prove, and shows no reason, in fact, why the same diligence which now discovers the testimony would not have done so before. So far as the petition shows no witness proposes to testify who was inquired of or sought for before the former hearing. Nor is it pointed out by what means such testimony can now be procured that was not equally available by proper diligence long ago. If the court was authorized to reopen the case it would be only for the purpose of letting in the evidence of specifically named witnesses, with an affidavit of such witnesses
116 as to what they would prove. The case is distinguishable from Campbell *vs.* Marden, 70 F. R., 339. In that case the offer was to produce new evidence by which to make out the defense of prior invention. Here the effort is to introduce merely cumulative evidence in support of a defense as to which the evidence was fully gone into on the former preparation of the case and before the final hearing.

CLARK, *J.*

The following decree was entered upon the mandate from the circuit court of appeals, viz:

THE MECHANICS' SAVINGS BANK AND TRUST COMPANY
vs.
THE GUARANTEE COMPANY OF NORTH AMERICA, ET AL.

Be it remembered that this cause came on to be heard further before the Hon. C. D. Clark, judge, etc., upon the mandate from the circuit court of appeals for the sixth circuit, as follows:

The United States Circuit Court of Appeals for the Sixth Circuit.

THE GUARANTEE COMPANY OF NORTH AMERICA, Appellant,
vs.
THE MECHANICS' SAVINGS BANK AND TRUST COMPANY, Appellee.

This cause came on to be heard upon the mandate from the Supreme Court of the United States, which contained the following decree:

"On consideration whereof it is now here ordered, adjudged and decreed by this court that the decree of the said United States circuit court of appeals in this case be and the same is hereby reversed with costs, and that the said appellant, The Guarantee Company of North America, recover against the said appellee three hundred and sixty-seven dollars and sixty-five cents for its costs herein expended and have execution therefor.

117 And it is further — that this cause be and the same is hereby remanded to the said United States circuit court of appeals with directions to dismiss the appeal prosecuted to that court and for such further proceedings in the circuit court of the United States for the middle district of Tennessee as may be consistent with law."

Pursuant to said mandate the appeal herein is hereby dismissed.

United States Circuit Court of Appeals, Sixth Circuit.

I, Frank O. Loveland, clerk of the United States circuit court of appeals for the sixth circuit, do hereby certify that the foregoing is a true and correct copy of the decree of June 10th, 1899, in the case of The Guarantee Company of North America *versus* The Mechanics' Savings Bank and Trust Company for the use of J. J. Pryor, assignee, No. 349, October term, 189–, as the same remains of record and upon the files of said United States circuit court of appeals for the sixth circuit and of the whole thereof.

In testimony whereof I have hereunto subscribed my name and affixed the seal of the said United States circuit court of appeals for the sixth circuit at the city of Cincinnati, this the fourteenth day of June, 1899.

[SEAL.] FRANK O. LOVELAND,
Clerk of the United States Circuit Court of Appeals for the Sixth Circuit.

Also upon the petition of the defendant seeking to have the case reopened for additional evidence, said petition being referred to for its contents. The said application being resisted by the plaintiff, the court is pleased to disallow the petition for the reasons set out in an opinion this day filed.

It is therefore ordered, adjudged and decreed by the court that the prayer of the petition of the defendant, The Guarantee Company of North America, be disallowed and that the decree of the United States circuit court of appeals for the sixth circuit be made

the decree of this court and H. M. Doak, special commissioner, will proceed with the reference heretofore ordered.

It is further ordered, adjudged and decreed by the court that the Guarantee Company of North America recover against the
118 plaintiff The Mechanics' Savings Bank and Trust Company for the use of J. J. Pryor, assignee, the sum of $367.65, in accordance with the decree of the United States circuit court of appeals for the sixth circuit for which execution will issue if not paid within ten days.

The following stipulation was filed, viz:

In this cause it is stipulated by counsel for each party that the clerk, in copying the transcript of the record for the circuit court of appeals, shall omit from the transcript as immaterial upon this appeal the following papers, to wit:

The appeal and assignments of error filed on August 1st, 1895; the citation, dated August 22, 1895; the bond filed on said appeal; with leave to either party to have same certified at any time.

This December 5th, 1899.

WM. L. GRANBERY,
Sol. for Defendant.
ED. H. EAST,
Sol. for Plaintiff.

The following order was entered, viz:

In this case it appearing to the court that this cause was dismissed by the plaintiff in the State court prior to its removal to this court against the Union Bank and Trust Company, administrator of John Schardt, it is ordered, adjudged and decreed by the court that this cause stand dismissed as against the Union Bank and Trust Company, administrator of John Schardt aforesaid.

The following final decree was rendered and entered of record, viz:

This cause came on to be heard before the circuit court of the United States for the middle district of Tennessee, upon the report of the commissioner, which report having been filed according to law and no exception having been taken or filed thereto, and the time to do so having been waived, the said report is in all things confirmed, in words and figures as follows:

THE MECHANICS' SAVINGS BANK & TRUST CO.
vs.
GUARANTEE COMPANY OF NORTH AMERICA.

119 In obedience to a decree heretofore pronounced in this cause, I respectfully report as follows:

That the trustee and assignee under the several assignments made by John Schardt of policies and properties, etc., to indemnify the complainant against loss by reason of his conduct as teller and cashier of complainant bank have realized upon the same the sum of $46,838.46. From life insurance, $45,284.03; other sources,

$1,544.43 and there will and can be no other or further sum realized thereon.

Respectfully submitted.

H. M. DOAK,
Special Commissioner.

Nov. 8th, 1899, Nashville, Tenn.

And thereupon, it appearing that the embezzlements of said Schardt during the currency of his bond as teller and collector is $78,819.24, without interest, and the interest on these various embezzlements from the end of each year to April 17th, 1893, is $5,276.00 and the total of principal and interest is $84,095.35 to April 17th, 1893; and it further appearing that the complainant has realized from policies and other sources the sum of $46,828.46, leaving the net amount due from said Schardt as teller and collector, during the currency of said bond, $37,266.89; and it further appearing that the plaintiff is therefore entitled to recover of the defendant the total amount of the penalty of the bond given as teller and collector, viz: $10,000.00, with interest thereon from April, the 9th day, 1894, to November 9th, 1899, making of interest, $3,350.00 and the aggregate of principal and interest, $13,350.00. And the court finds that there are no credits to be made upon the bond as cashier and that the plaintiff is entitled to recover the penalty of the said bond, viz: $20,000.00 and interest from April 9th, 1894, to November 9th, 1899, amounting to $6,700.00, making an aggregate of principal and interest of $26,700.00 and making the total recovery of plaintiff against defendant of $40,050.00.

The court therefore orders, adjudges and decrees that the Mechanics' Savings Bank and Trust Company, to the use of J. J. Pryor, assignee, have and recover of the Guarantee Company of North America the said sum of $40,050.00, together with interest thereon until paid and the costs of the suit, for all of which execution shall issue as at law.

120 MECHANICS' SAVINGS BANK & TRUST COMPANY, to the Use of J. J. Pryor, Assignee,
vs.
THE GUARANTEE COMPANY OF NORTH AMERICA.

The above-named defendant, The Guarantee Company of North America, conceiving itself aggrieved by the final decree entered on the 5th day of December, 1899, in the above-entitled proceeding, and because of manifest errors therein, as is more fully shown and set forth in an assignment of errors this day filed, does hereby appeal from said decree to the United States circuit court of appeals for the sixth circuit, and it prays that its appeal may be allowed, and also that an order be made fixing the amount of security which the defendant shall give and furnish upon such appeal, and upon the giving of such security and bond all further proceedings in this court shall be superseded and stayed until the determination of said appeal by the United States circuit court of appeals for the sixth circuit; and that a transcript of the record and proceedings and

papers upon which said decree was made, duly authenticated, may be sent to the United States circuit court of appeals for the sixth circuit.

WM. L. GRANBERY,
Solicitor for Petitioner.

On reading and filing the petition of The Guarantee Company of North America, defendant herein, for an order allowing an appeal, and the assignment of errors herein made and filed, it is ordered that an appeal to the United States circuit court of appeals for the sixth circuit from a final decree heretofore made, entered and filed herein on the 5th day of December, 1899, be and the same is hereby allowed; and that a transcript of the record be forthwith transmitted to the United States circuit court of appeals for the sixth circuit.

It is further ordered that the amount of security on appeal herein to be furnished by the said Guarantee Company of North America be and the same is hereby fixed at the sum of $3,000.00, and that upon the making and filing with the clerk of this court of a
121 good and sufficient bond in said sum by the Guarantee Company of North America, all further proceedings, including an execution on said final decree, be superseded and stayed until the final determination of said appeal by the said United States circuit court of appeals, and until the further order of this court.

Assignment of Errors.

Now, to wit, on the 5th day of December, in the year of our Lord, 1899, at the October term of the circuit court of the United States for the middle district of Tennessee, in the city of Nashville and State of Tennessee, comes the said Guarantee Company of North America, by Wm. L. Granbery, its solicitor, and says that in the record and proceedings in the above-styled cause there is manifest error in this, to wit:

I.

In re cashier's bond.

1. The court erred in not sustaining the defense of a fraudulent and material misrepresentation by which the said bond was procured, such misrepresentation being that the books and accounts of said employé had been examined and found correct December 31st, 1892.

2. The court erred in not sustaining the defense of a suppression of material matters affecting the risk, to wit, the fact that said employé had been known to have engaged in speculation and to have owned an interest in a brokerage concern while the teller of said bank.

3. The court erred in holding defendant liable for $5,992.35 of overdrafts by customers of the bank, because the defendant only contracted to pay losses occasioned by the fraudulent acts of said employé and constituting larceny or embezzlement.

4 The court erred in holding that said bond was ever in force or ever took effect.

II.

In re teller's bond.

1. The court erred in not sustaining the defense of a material and fraudulent misrepresentation made by the complainant bank to procure a renewal of said bond in January, 1892, said misrepresentation being that the books and accounts of the employé Schardt had been examined in December, 1891, and verified.

122 2. The court erred in not sustaining the defense of a failure on the part of the bank to notify the defendant of speculation by said employé during the currency of the bond.

3. The court erred in not sustaining the defense of the failure of the bank to cause to be observed all due and customary supervision of said employé to prevent a default during the currency of the bond.

4. The court erred in not sustaining the defense of the failure of the bank to make a proper inspection or audit of the books and accounts of said employé once each year during the currency of the bond.

5. The court erred in not dismissing the bill as to said bond.

Wherefore the said Guarantee Company of North America prays that an appeal may be allowed it from said decree holding it liable on said bonds to the end that said decree may be corrected and speedy justice done it.

WM. L. GRANBERY,
Solicitor for Defendant.

UNITED STATES OF AMERICA, *Sixth Judicial Circuit,* } *ss:*

United States Circuit Court of Appeals for the Sixth Circuit.

To the Mechanics' Savings Bank & Trust Company, for the use of J. J. Pryor, assignee, Greeting:

You are hereby cited and admonished to be and appear at a session of the United States circuit court of appeals, to be holden in the city of Cincinnati, in said circuit, on the 27th day of December next, pursuant to an appeal filed in the clerk's office of the circuit court of the United States for the middle district of Tennessee, wherein The Mechanics' Savings Bank & Trust Company, to use, etc., is complainant, and The Guarantee Company of North America is defendant, to show cause, if any there be, why the decree rendered against the said defendant should not be corrected and speedy justice done to the parties in that behalf.

Witness the Honorable Melville W. Fuller, Chief Justice of the United States, this the 7th day of December, 1899, and of the American Independence the 124th year.

C. D. CLARK, *Judge.*

123 The undersigned Mechanics' Savings Bank & Trust Company, for the use of J. J. Pryor, assignee, does hereby acknowledge service of the foregoing citation on appeal, this the 7th day of December, 1899.

MECHANICS' SAVINGS BANK & TRUST COMPANY, TO THE USE OF J. J. PRYOR, ASSIGNEE.
By EDWARD H. EAST, *Solicitor.*

Know all men by these presents, that we, the Guarantee Company of North America, and William L. Granbery as surety, are hereby held and firmly bound unto the Mechanics' Savings Bank & Trust Company, *for the use of J. J. Pryor, assignee, in the full* and just sum of $3,000.00, to be paid the said Mechanics' Savings Bank & Trust Company, to the use of J. J. Pryor, assignee, its certain attorneys or assigns, to which payment, well and truly to be made, we bind ourselves, our heirs and personal representatives jointly and severally by these presents.

Sealed with our seals and dated this the 5th day of December, 1899.

Whereas, lately at a circuit court of the United States for the middle district of Tennessee, in a suit pending in said court between the first party and the second party, a decree was rendered against the first party, and the said party having prayed and obtained an appeal and filed a copy thereof in the clerk's office of said court to reverse the decree in the aforesaid suit, and a citation directed to the second party citing and admonishing it to be and appear at a session of the United States circuit court of appeals for the sixth circuit, to be holden at the city of Cincinnati in said circuit, on the 27 day of December, 1899, next.

Now the condition of the above obligation is such that if the said defendant shall prosecute its appeal to effect, and answer all debt, damages and cost if it shall fail to make its appeal good, then the above obligation to be void, otherwise to remain in full force and virtue.

GUARANTEE COMPANY OF NORTH AMERICA,
By WM. L. GRANBERY, *Attorney.*
WM. L. GRANBERY, *Surety.*

Certificate.

I, H. M. Doak, clerk of the circuit court of the United States
124 for the middle district of Tennessee, hereby certify that the foregoing is a true, perfect and complete copy of the record in the above-styled cause, as the same is of record and on file in my office.

In witness whereof I have hereunto signed my name and affixed the seal of the court.

Done at my office in Nashville, State and district above set out, upon this the 7th day of December, A. D. 1899.

[SEAL.] H. M. DOAK, *Clerk.*

125 And afterwards, to wit, on December 11th, 1899, præcipe for appearance was filed in said cause, which reads and is as follows:

United States Circuit Court of Appeals for the Sixth Circuit, October Term, 1899.

GUARANTEE CO. OF NORTH AMERICA
vs.
MECHANICS' SAVINGS BANK & TRUST CO. } No. 792.

To the clerk of said court:

Please enter my appearance as counsel for the appellant.

WM. L. GRANBERY.

And afterwards, to wit, on March 19th, 1900, an entry was made upon the journal of said court, which is in the words and figures as follow-:

United States Circuit Court of Appeals for the Sixth Circuit.

GUARANTEE CO.
vs.
SAVINGS BANK & TRUST CO. }

This cause came on to be heard this day and was argued on behalf of the appellant by Mr. Wm. L. Granbery and on behalf of the appellee by Mr. Edward H. East and was submitted.

126 And afterwards, to wit, on March 24th, 1900, a decree was rendered in said cause, clothed in the words and figures as follows:

Decree.

127 United States Circuit Court of Appeals for the Sixth Circuit.

GUARANTEE CO. OF NORTH AMERICA
v.
MECHANICS' SAVINGS BANK & TRUST CO., for the Use of J. J. Pryor, Assignee. } No. 792.

Appeal from the circuit court of the United States for the middle district of Tennessee.

This cause came on to be heard on the transcript of the record from the circuit court of the United States for the middle district of Tennessee and was argued by counsel.

On consideration whereof it is now here ordered, adjudged, and decreed by this court that the decree of the said circuit court in this cause be, and the same is hereby, affirmed, except as to so much of the item of $5,992.35 overdrafts as may have been included in the decree and so as to limit the recovery on the cashier's bond to

$16,971.82 and interest thereon; costs of appeal to be borne equally by appellant and appellees, and the cause is remanded to the circuit court, with directions to modify its judgment to the extent indicated.

128 And on the same day, to wit, on March 24th, 1900, an opinion was rendered in said cause, which is in the words and figures as follows:

Opinion.

129 United States Circuit Court of Appeals, Sixth Circuit.

THE GUARANTEE COMPANY OF NORTH America, Appellant, *v.* THE MECHANICS' SAVINGS BANK AND Trust Company, for the Use of J. J. Pryor, Assignee, Appellee.	No. 792. Appeal from the Circuit Court of the United States for the Middle District of Tennessee.

Submitted March 19, 1900; decided March 24, 1900.

Before Lurton and Day, circuit judges, and Evans, district judge.

EVANS, district judge, delivered the opinion of the court:

The facts in this case are fully stated in the opinion of the court announced, when it was previously here, and which is reported in 80 Fed. Rep., 766. They need not be repeated further than to say, generally, that the action is based upon the stipulations of two separate covenants executed by one John Schart to the Mechanics' Savings Bank and Trust Company, with the appellant as surety on each, one binding the appellant to make good losses which might result from the misconduct of Schart as teller and book-keeper of the bank, and the other to make good those losses of the bank not exceeding $20,000, which might result from such fraudulent conduct of Schart, as its cashier, as should be equivalent to embezzlement or larceny.

After the case was decided here it was removed by a writ of certiorari into the Supreme Court of the United States, where the judgment was reversed upon the single ground that the
130 court had not jurisdiction of the appeal, because the judgment upon which the appeal was taken was not final. (173 U. S., 582.)

Upon the return of the case to the circuit court a final judgment was rendered. This judgment, however, was substantially the same as the one upon which the first appeal had been taken.

Upon the pending appeal, and, as the case is again presented, various errors are assigned, some based upon the judgment of the circuit court as it applied to the teller's bond, and others upon the judgment as it applied to the bond of Schart as cashier. Without again stating the reasons therefor, which were elaborately given in the former opinion of this court, we deem it sufficient to say that

we reaffirm the conclusions of the court there announced, except in respect to that error complained of which relates to the sum of $5,992.35, made up of overdrafts upon the bank which had, without its authority, been paid by the cashier. It is true that this question was also passed upon when the case was heard before, but coming to us again we find ourselves unable, as the matter is now presented, to agree to what was then said upon that point.

The cashier's bond stipulated that the appellant, as surety, should make good those losses of the bank which might result from such fraudulent actions of Schart, the cashier, as were equivalent to embezzlement or larceny. The obligation of the surety by its express terms was limited to that character of wrong-doing upon the cashier's part. The evidence in the case is very explicit that the defalcations of Schart during the period when the cashier's bond was in force, namely, from January 1, 1893, to April 17, 1893, was $22,964.17, of which the sum of $5,992.35 was on account of overdrafts paid by him, but not authorized by the bank. This defalcation, even if it had been in some respects fraudulent, must necessarily have been on account of moneys paid out on the checks of customers who had no funds to their credit to meet them, but it is not shown that Schart embezzled or appropriated any part of the proceeds of these overdrafts or received any benefit therefrom. If this be true, it is manifest that while Schart was individually responsible for it to the bank as his principal, no act was done by him which was either embezzlement or larceny and consequently that the loss was not one, which, by any fair interpretation, would bring it within the obligation of the surety or the bond of the cashier.

It is insisted, however, that this question was not brought to the attention of the court below and cannot for that reason be
131 reviewed here. It is altogether certain that the appellee should not recover from the surety anything which is not embraced within the terms of the contract, and the pleading by which this action was commenced could not properly claim anything else, and in fact did not. By its answer the appellant in plain terms admitted certain abstractions of money by Schart from the funds of the bank, but it by no means admitted, on the contrary, it expressly denied, the accuracy of complainant's averments as to the amount thereof. While this denial of the answer may not have been as explicit as the complainant could have demanded, and as it may have been entitled to demand, still it was in no sense an admission that the charges of the bill were accurate as to the amount of loss that came within the stipulation of the surety. The complainant took no step by exception to the answer or otherwise, to have the issue on that point made more distinct or definite. This condition of the pleadings left the burden upon the complainant to show the extent of its losses resulting from such fraudulent actions of Schart as were equivalent to embezzlement or larceny. As has been indicated, losses from acts of that character are shown by the evidence only to the extent of $16,971.82, instead of $22,964.17, as adjudged by the court below, the difference being the amount of the

overdrafts which were paid out by Schart instead of being received by him by any act which, in anywise, resembled embezzlement or larceny. We think this question legitimately and necessarily arose upon the record when the case was heard upon all the testimony presented whether the attention of the court was specifically called to it or not before the time of settling the decree, when, in fact, it does appear to have been urged or at least mentioned to the court. This was not a matter of form, merely, which might be regarded as waived if not insisted upon, but was matter of substance arising upon the record and vitally affecting the correctness of the court's decree, which must be based upon the record and supported by the evidence. It is not, therefore, too late to insist upon it here, and it appears to us to be entirely obvious that the judgment appealed from was erroneous to the extent indicated, though in all other respects correct.

It results from what has been said that the judgment of the circuit court should be affirmed except as to so much of the item of $5,992.35 as may have been included in the decree and so as to limit the recovery on the cashier's bond to $16,971.82 and interest thereon. The case is, therefore, remanded to the circuit court with directions to modify its judgment to the extent indicated. The costs of this appeal to be borne equally by appellant and appellee.

132 United States Circuit Court of Appeals for the Sixth Circuit.

I, Frank O. Loveland, clerk of the United States circuit court of appeals for the sixth circuit, do hereby certify that the foregoing is a true and correct copy of the record & proceedings in the case of The Guarantee Co. of North America *vs.* The Mechanics' Savings Bank & Trust Co., for the use of J. J. Pryor, assignee, No. 792, October term, 1899, as the same remains upon the files and records of said United States circuit court of appeals for the sixth circuit, and of the whole thereof.

Seal United States Circuit Court of Appeals, Sixth Circuit.

In testimony whereof I hereunto subscribe my name and affix the seal of said United States circuit court of appeals for the sixth circuit, at the city of Cincinnati, Ohio, this fourteenth day of April, 1900.

FRANK O. LOVELAND,
Clerk of the United States Circuit Court of Appeals for the Sixth Circuit.

133 UNITED STATES OF AMERICA, *ss:*

[Seal of the Supreme Court of the United States.]

The President of the United States of America to the honorable the judges of the United States circuit court of appeals for the sixth circuit, Greeting:

Being informed that there is now pending before you a suit in which The Guarantee Company of North America is appellant and The

Mechanics' Savings Bank and Trust Company, for the use of J. J. Pryor, assignee, is appellee, which suit was removed into the said circuit court of appeals by virtue of an appeal from the circuit court of the United States for the middle district of Tennessee, and we, being willing for certain reasons that the said cause and the record and proceedings therein should be certified by the said circuit court of appeals and removed into the Supreme Court of the United
134 States, do hereby command you that you send without delay to the said Supreme Court, as aforesaid, the record and proceedings in said cause, so that the said Supreme Court may act thereon as of right and according to law ought to be done.

Witness the Honorable Melville W. Fuller, Chief Justice of the United States, the fifteenth day of May, in the year of our Lord one thousand nine hundred.

JAMES H. McKENNEY,
Clerk of the Supreme Court of the United States.

UNITED STATES OF AMERICA, } ss:
Sixth Judicial Circuit, }

I return the above writ of certiorari pursuant to a stipulation filed in my office this 18th day of May, 1900. Said stipulation is as follows:

"In the Supreme Court of the United States.

GUARANTEE COMPANY OF NORTH AMERICA
vs.
MECHANICS' SAVINGS BANK & TRUST COMPANY, for the Use of J. J. Pryor, Assignee.

Whereas the Supreme Court of the United States did on May 14, 1900, grant the petition of the Guarantee Company of North America praying for a writ of certiorari, directed to the circuit court of appeals for the sixth circuit, to take up said above-styled cause for review in the Supreme Court of the United States; and whereas under the practice of the Supreme Court of the United States a certified copy of the record filed with the petition for certiorari may be treated as a sufficient return to the writ of certiorari, provided there is a stipulation by the parties filed with the clerk of the circuit court of appeals:

Now, therefore, it is hereby stipulated that the certified copy of the record filed with the petition for certiorari may be treated as a return to the writ of certiorari and a certified copy of this stipulation may be forwarded by the clerk of the circuit court of appeals for the sixth circuit in lieu of a new certified copy of the record.

Nashville, Tennessee, May 17, 1900.

GUARANTEE COMPANY OF NORTH AMERICA,
By WM. L. GRANBERY, *Attorney.*
MECHANICS' SAVINGS BANK & TRUST CO., TO USE, ETC.
By EDW. H. EAST, *Attorney.*"

Seal United States Circuit Court of Appeals, Sixth Circuit.

In testimony whereof I have hereunto set my hand and affixed the seal of this court, at my office, in Cincinnati, Ohio, this 18th day of May, A. D. 1900.

FRANK O. LOVELAND,
Clerk of the United States Circuit Court of Appeals for the Sixth Circuit.

135 [Endorsed:] File No., 17,731. Supreme Court of the United States, October term, 1900. No. 261. The Guarantee Co. of North America *vs.* The Mechanics' Savings Bank & Trust Co., use, &c. Writ of certiorari and return. Filed May 21, 1900.

Endorsed on cover: File No., 17,731. U. S. C. C. of appeals, 6th circuit. Term No., 261. The Guarantee Company of North America, petitioner, *vs.* The Mechanics' Savings Bank and Trust Company, for the use of J. J. Pryor, assignee. Filed April 28th, 1900.

Supreme Court
FILED
APR 28 1900
JAMES H. McKENNEY,
Clerk

6947. Box 48

SUPREME COURT OF THE UNITED STATES,

OCTOBER TERM, 1899.

Guarantee Company of North America

v.

Mechanics' Savings Bank & Trust Co.,

For the use of J. J. Pryor, Assignee.

PETITION OF THE GUARANTEE COMPANY OF NORTH AMERICA FOR WRIT OF CERTIORARI

Requiring the Circuit Court of Appeals for the Sixth Circuit to Certify the Case to the Supreme Court, for its Review and Determination.

WM. L. CRANBERY,
COUNSEL.

IN THE

SUPREME COURT OF THE UNITED STATES,

OCTOBER TERM, 1899.

Guarantee Company of North America

v.

Mechanics' Savings Bank & Trust Co.,

For the use of J. J. PRYOR, Assignee.

PETITION FOR WRIT OF CERTIORARI

REQUIRING THE CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT, TO CERTIFY TO THE SUPREME COURT, FOR ITS REVIEW AND DETERMINATION, THE CASE OF THE GUARANTEE COMPANY OF NORTH AMERICA, APPELLANT, V. THE MECHANICS' SAVINGS BANK & TRUST COMPANY, FOR THE USE OF J. J. PRYOR, ASSIGNEE, APPELLEE.

To the Honorable the Supreme Court of the United States:

Your petitioner, the Guarantee Company of North America, respectfully shows to this Honorable Court as follows:

Your petitioner is, and has been since 1872, a corporation chartered and organized under the laws of the Dominion of Canada, engaged, under authority of its charter, in the business of guaranteeing the fidelity of persons in positions of trust. The Mechanics' Savings Bank and Trust Company was, in the year 1888 and prior thereto, a corporation, chartered and organized under the general laws of the State of Tennessee, engaged, under

the authority of its charter, in the business of a bank of deposit and discount and in accepting and executing various trusts, having a capital of $50,000.

Among its other officials and employees, required in the conduct of its corporate business, was one John Schardt, who was its teller and collector from January 16, 1888, to January 1, 1893, and its cashier from January 1, 1893, to April 17, 1893. On January 16, 1888, in consideration of the payment of a premium of $100.00, petitioner entered into a contract with the Mechanics' Savings Bank and Trust Company, being bond No. 93,525, in the penalty of $10,000, agreeing to make good and reimburse to it such pecuniary loss as it should sustain by the fraudulent acts of John Schardt in connection with the duties of his office of teller and collector for a term of one year thereafter. In the bond evidencing the contract, it was stipulated, among other things:

"The following provisions are also to be observed and binding as a part of this bond:

. . . . . .

"That the employer (meaning said Mechanics' Savings Bank and Trust Company) shall observe or cause to be observed all due and customary supervision over the said employee (meaning said Schardt), for the prevention of default.

. . . . . .

"That the employer shall at once notify the Company of his becoming aware of the said employee being engaged in speculation or gambling or indulging in any disreputable or unlawful habits or pursuits.

"That there shall be an inspection or audit of the accounts or books of the employee on behalf of the employer at least once in every twelve months from the date of this bond."

The bond so entered into was renewed from year to year, until January 1, 1893, but at no time until the Mechanics' Savings Bank and Trust Company had certified that the accounts of said Schardt, for the year just ended, had been examined and verified.

The said employer ceased to observe, or cause to be observed, due and customary supervision over the said Schardt for the pre-

vention of default, and, on September 12, 1890, he began to default, by embezzling the funds of his employer. He continued his default, and embezzled by constant and continued abstractions, amounts as follows: From September 12, 1890, to January 16, 1891, $5,879.34; from January 16, 1891, to January 1, 1892, $22,290; from January 1, 1892, to January 1, 1893, $50,649.90. The amounts so embezzled he lost in speculations on stocks, grain, cotton, and other commodities.

In the summer or fall of 1892, one Kyle, of New York, representing Myers & Company, of that city, came to Nashville, and proposed to Charles Sykes, then cashier of the Mechanics' Savings Bank and Trust Company, to become interested in the "brokerage" business, and to represent Myers & Company at Nashville. Cashier Sykes replied that he did not like the idea, because it was a purely speculative business. Mr. Kyle then said that that made no difference, that the teller of the Bank, John Schardt, was a part owner in a similar concern. Cashier Sykes at once told Lewis T. Baxter, the President of the Mechanics' Savings Bank and Trust Company, of the conversation. The next day he told John Schardt of what Mr. Kyle had said. Said Schardt then admitted to said Sykes that he had at one time been interested in such a concern, but said he had sold his interest. In this same conversation he admitted to Cashier Sykes that he had speculated to some extent, but had made money on every transaction, and had seen the error of his way and ceased to do so any more. Cashier Sykes immediately told President Baxter of what said Schardt had said.

Some time thereafter, Cashier Sykes received an anonymous letter telling him that Schardt had been speculating. He showed it to President Baxter, but he said not to pay any attention to it. Cashier Sykes spoke to said Schardt about it. Said Schardt said that he thought that he knew the author, and asked that he be given the letter, and said that he would bring the party before Mr. Sykes, and make him acknowledge that it was false. Mr. Sykes

gave him the letter, and asked him about it several times. Said Schardt always replied that he was working on the matter. Mr. Sykes told President Baxter of these conversations.

At some time before January 1, 1893, Mr. J. M. Eatherly, a stockholder, director, and chairman of the finance committee of the Mechanics' Savings Bank and Trust Company, saw a letter to the effect that Schardt was a partner in a "bucket shop," directed to John Woodard, another director. When Woodard showed it to him, said Eatherly asked permission to call Mr. Schardt up and show it to him, and said that there was a communication that he wanted him to read. Said Schardt read the letter, and remarked, "It's a lie, and I can prove it." Mr. Eatherly told Mr. Schardt that it devolved on him to prove it false. Mr. Schardt immediately went out, and returned with one Frank Searight and a Dr. Barry. President Baxter, Woodard, and Eatherly went to the rear of the Bank building with Schardt and Messrs. Searight and Barry. In this conference, Mr. Searight said that at some time before, Mr. Schardt, Dr. Barry, and himself, had agreed to open a "brokerage association," each contributing $200 to its capital. For some reason Mr. Schardt became dissatisfied in a short time, and sold his interest to Mr. Searight.

Subsequent to that conversation, and before January 1, 1893, Mr. Eatherly again heard that Schardt was speculating. He went to Schardt's house to see him about it, and told him what he had heard. Schardt said it was not so, that he did not own any stocks at all, having sold everything he had. Mr. Eatherly told him that if he was speculating, he ought to quit that or quit the Bank.

Petitioner had caused to be inserted in the bond of suretyship the condition referred to, providing that the employer should at once notify petitioner on its becoming aware of the said employee being engaged in speculation or gambling, for the reason that petitioner declines to become, or remain, the surety of any person

in a fiduciary position who speculates, since petitioner has found, by long experience, that such a person can not be safely trusted. Had the Mechanics' Savings Bank and Trust Company notified petitioner of the facts so made known to it through its president, its cashier, and two of its directors, and a member of its finance committee, petitioner would have at once retired from said bond and canceled the same. When such information did in fact come to petitioner through other sources, in April, 1893, petitioner immediately canceled another bond it had issued to the Mechanics' Savings Bank and Trust Company, guaranteeing the fidelity of said John Schardt in the position of cashier.

But the Mechanics' Savings Bank and Trust Company wholly failed to comply with its undertaking in said bond, and did not notify petitioner of its becoming aware of said Schardt being engaged in speculation, as hereinbefore set out. On becoming aware thereof, it did not dismiss said Schardt from its employ, nor did it cause his accounts to be examined. Such examination would have immediately disclosed his large embezzlements, lost in the speculations he admitted himself to have been engaged in. On the contrary, it retained him in its employ, and, on January 1, 1893, promoted him by election to be its cashier.

Thereupon, the Mechanics' Savings Bank and Trust Company made application to petitioner to become the surety of said John Schardt, in the sum of $20,000, in his new position of cashier. For the purpose of determining whether or not it would become such surety, and before it would consent thereto, petitioner required Lewis T. Baxter, president of said Mechanics' Savings Bank and Trust Company, to make in its application for such bond, written answers to certain material questions. Among other such questions regarding said Schardt, and answers thereto, were the following:

"Have you ever known or heard anything unfavorable as to his habits, past or present?

"No.

"Or of any matters concerning him about which you deem it advisable for the Company to make inquiry?

"No.

"When were applicant's (Schardt) books and accounts (including cash, securities, and vouchers, if any), last examined, and by whom?

"*Answer* — December 31, 1892, by finance committee (were they found correct?) of Bank and found correct."

In making such answers, instead of disclosing the facts regarding the speculations by said Schardt, of which he had not only heard, but of which he knew by said Schardt's admissions, he concealed the same, and made false and untrue answers to the questions. And at the time this statement was made that the books and accounts of the employee had been examined and found correct, the books of the Bank were out of balance $69,700, representing the default of the employee; and the notes in the Bank were less by $4,015.44 than the amount of notes called for upon the books of the Bank, which also represented a default by the employee.

By the terms of the subsequent contract, the Mechanics' Savings Bank and Trust Company agreed that any misstatement of a material fact in said application would render the bond void from the beginning.

But, misled by the false answers to the said questions, and deceived by the suppression of the facts known to said Mechanics' Savings Bank and Trust Company, and its president, Lewis T. Baxter, on January 1, 1893, petitioner issued and delivered to the Mecanics' Savings Bank and Trust Company, its bond, number 154,806, in the penalty of $20,000, whereby petitioner covenanted to reimburse to the Mechanics' Savings Bank and Trust Company, its representatives or assigns, the amount of any loss not exceeding $20,000, which should be sustained by it during the year 1893, by reason of any act of fraud committed by said Schardt, in connection with the duties of cashier, and constituting embezzlement or larceny.

After the issuance and delivery of said bond, the Mechanics' Savings Bank and Trust Company failing to exercise due and customary supervision over said Schardt for the prevention of default, said Schardt continued his embezzlements, and between the date the bond came into force and April 15, 1893, he embezzled the further sum of $16,971.82.

On April 15, 1893, after petitioner had learned of the speculations on the part of said Schardt, and, in consequence, had canceled the said bond, notifying the said Mechanics' Savings Bank and Trust Company that such cancellation was on account of learning of such speculations, said Mechanics' Savings Bank and Trust Company caused the books and accounts of said Schardt to be examined. Such examination, continuing during a part of that day, disclosed a shortage amounting to more than $100,000, to which said Schardt confessed. Knowing the whole of the capital stock of the Bank, and possibly a greater sum, to have been lost by the default of said Schardt, the board of directors of the Mechanics' Savings Bank and Trust Company, on April 17, 1893, the first business day after such discovery, caused to be executed a general assignment to James J. Pryor, conveying to him all its assets, for the equal benefit of all its creditors.

On April 19, 1894, James J. Pryor, a citizen of the State of Tennessee, as such assignee, filed his bill in the Chancery Court of Davidson County, Tennessee, in the name of the Mechanics' Savings Bank and Trust Company, for his use, against petitioner and the Union Bank and Trust Company, a corporation of the State of Tennessee, as administrator of John Schardt, who died on April 17, 1893, alleging, among other things, the holding by the said Schardt of the offices of teller and cashier, the issuance and delivery of the said two bonds of suretyship by petitioner, and the renewals of the first thereof, and the defaults above set out on the part of said Schardt, and praying for the taking of an account of such defaults and recoveries on said bonds for the full amounts thereof.

On June 11, 1894, and before the time petitioner was required to make defense to the bill under the laws of Tennessee, petitioner removed said cause to the United States Circuit Court for the Middle District of Tennessee, on the ground that petitioner, one of the defendants therein, was not a citizen of the State of Tennessee, but was a citizen of the Dominion of Canada, alleging that there existed in said suit a controversy between complainant and petitioner, which could be fully determined as between them.

On the same day, to wit: on July 11, 1894, petitioner filed its answer in said cause, setting up, among other things, the breaches on the part of the Mechanics' Savings Bank and Trust Company, of the conditions of the first bond on John Schardt, as teller and collector, whereby said Mechanics' Savings Bank and Trust Company agreed to observe, or cause to be observed, all due and customary supervision over said employee for the prevention of default, and to inspect or audit his accounts and books at least once a year, and to at once notify petitioner on its becoming aware of the said employee being engaged in speculation or gambling, or indulging in any disreputable or unlawful habits or pursuits, setting up that the certificates made yearly that the accounts of said employee had been examined and verified and found correct, on faith of which the yearly renewals were granted, were false and untrue; and setting up that the second bond, that on John Schardt as cashier, was issued on the faith of the representations of Lewis T. Baxter, president of the Mechanics' Savings Bank and Trust Company, that he had neither known nor heard anything unfavorable as to said Schardt's habits and associations, and that he neither knew nor had heard of any matters concerning which he deemed it advisable for petitioner to make inquiry, when in fact said Baxter knew of said Schardt's having been engaged in speculations, and being a partner in a firm organized to carry on a purely speculative business. That the books of the Bank show a very large default, which could have been detected by the slightest examination, and could not have been concealed if any examina-

tion whatever had been made. These matters and things, among others, petitioner set up to defeat a recovery on said two bonds.

The said cause was and is entitled in the Circuit Court of the United States for the Middle District of Tennessee, "The Mechanics' Savings Bank and Trust Company, to the use of J. J. Pryor, Assignee, etc., *v.* The Guarantee Company of North America."

Such proceedings were had in said case in said Circuit Court of the United States that, on July 1, 1895, the said Court rendered a decree therein, the material part of which is as follows:

The Court is of opinion and adjudges and decrees as follows:

That Schardt has been a defaulter within the sense of his two bonds; that in the years 1890 and 1891, the amount of his embezzlement from the Bank was comparatively small and has been paid out of assets and collections theretofore transferred to the Bank by Schardt to secure it, just before his death; that the embezzlements for the year commencing September 1, 1890, to January 16, 1891, amounting in the aggregate to $5,879.34, with interest to April 15, 1893, of $890.04, makes $6,769.38. From January 16, 1891, to January 1, 1892, $22,290.00, interest to April 15, 1893, of $2,299.08, added, makes $24,589.08. From January 1, 1892, to January 1, 1893, $50,649.90, with interest to April 15, 1893, of $2,086.27 added, makes $52,736.17; and these from January 1, 1893, to April 17, 1893, during the currency of his said bond as cashier, to $22,964.17, which, with interest to April 15, 1893, of $164.52, makes the sum of 23,128.69, in the aggregate; and that the total amount of said embezzlements during all the years mentioned in both positions, was of principal, $101,783.41, which, with interest to April 15, 1893, of $5,439.91 added, makes an aggregate of $107,223.36.

It appearing that Schardt had assigned to the Bank to indemnify it against loss, two lots of land assigned to J. B. Richardson, and life insurance policies amounting to $80,000.00, some of which policies have been paid to the assignee without suit, and others are now in litigation in this Court, or pending on appeal or writ of error to the Appellate Court of this Circuit, held at Cincinnati, the Court adjudges upon inspection of said guaranty bonds, their terms and various conditions, and the proof submitted, that the Bank has complied with the same and all its undertakings thereunder, substantially; and that said Schardt embezzled and fraudulently appropriated the moneys of the Bank while he filled

said two positions, to the amounts named; and that interest should be calculated upon said sums from the end of his respective terms.

The Court, after considering the various and numerous defenses set up by defendant Company, why a recovery should not be had upon either of said bonds, or both, in favor of complainant, is pleased to disallow each and all of said defenses, and to order, adjudge, and decree that complainant have its decree or judgment against the defendant, The Guarantee Company, upon each of said bonds, with interest from the time the same should have been paid, according to the terms of said bonds, and for the costs.

And the Court orders and decrees that the liability of the defendant, The Guarantee Company, is secondary to that of John Schardt's estate; and that the Bank or its assignee shall account for all collections realized on assets or collaterals turned over to the Bank by said Schardt to reimburse it against his shortage, which it has collected, or with due diligence may collect hereafter; and for his fitness, and for convenience, H. M. Doak, is appointed Master Commissioner to report the same to the next term of this Court; and the Court orders that the same be applied to the shortage of said Schardt in the order in which the same occurred, and in the meantime no execution will issue against defendants for the same, but only for the costs; and the Court orders that this cause may be continued upon the docket of this Court, for the purpose only of making any orders necessary to apply all collections from assets of Schardt, held as collateral, in exoneration, to that extent, of the defendant Company and of substituting the defendant to the rights of the Bank, in case the recovery herein is collected or paid, and any of said assets remain above the amount necessary to satisfy the shortage. But the case is retained for no other purpose, and the decree against defendant Company is final as fixing its liability on the bonds to make good the shortage, whatever that may be.

The said case in the said Circuit Court of the United States was heard before and decided by the Hon. C. D. Clark, District Judge for the Middle and Eastern Districts of Tennessee, sitting in said Court, and the opinion of the Court was delivered by him.

Your petitioner, on August 18, 1895, was duly allowed by said Circuit Court an appeal from its said decree to the United States Circuit Court of Appeals for the Sixth Circuit, and

On August 28, 1895, a certified transcript of the record and of

all proceedings of the said Circuit Court in said case was filed in the United States Circuit Court of Appeals for the Sixth Circuit, and the said case was entered and docketed in the said Court of Appeals and entitled "The Guarantee Company of North America, appellant, v. The Mechanics' Savings Bank and Trust Company, for the use of J. J. Pryor, Assignee, etc., appellee. No. 349."

The cause was heard in said Circuit Court of Appeals on December 11 and 12, 1895, before the Hon. Wm. H. Taft and the Hon. Horace H. Lurton, United States Circuit Judges for the Sixth Circuit, and the Hon. Eli S. Hammond, United States District Judge for the Western District of Tennessee; and, on October 5, 1896, the said Court rendered a decree affirming the said decree of said Circuit Court therein, as follows:

"This cause came on to be heard on the transcript of the record from the Circuit Court of the United States for the Middle District of Tennessee, and was argued by counsel. On consideration whereof, it is now here ordered, adjudged, and decreed by this Court that the decree of the said Circuit Court in this cause be, and the same is hereby, affirmed with costs."

Afterwards, and on October 28, 1896, in the said case in the said Circuit Court of Appeals, on motion of petitioner's counsel, an order was entered, extending the time for petitioner to file a petition for rehearing for thirty days from the day upon which the printed copy of the opinion of the Court in the case should be deposited in the clerk's office.

On April 29, 1897, such printed copy of the opinion of the Court in the case was deposited in the clerk's office.

Afterwards, and on May 27, 1897, petitioner filed its petition in said case in said Circuit Court of Appeals, praying to have said cause reheard, and if such rehearing should be denied, asking the said Circuit Court of Appeals to certify to this Honorable Court the important questions of law involved, for its determination, as provided by the sixth section of an Act of Congress, entitled "An

Act to establish Circuit Courts of Appeal, and to define and regulate in certain cases the jurisdiction of the Courts of the United States, and for other purposes," approved March 3, 1891.

Afterwards, and on July 6, 1897, the said Circuit Court of Appeals, being composed of the same Judges who had theretofore tried and determined the case, denied the petition for a rehearing.

Thereupon at the October, 1897, term of this Court, your petitioner presented its petition asking that the writ of certiorari be granted to bring up from the said Circuit Court of Appeals for the Sixth Circuit the transcript of the record, in order that the said decree might be reviewed and corrected in this Court. This petition was allowed and the certiorari granted, and thereupon said cause was duly brought to this Court and placed upon the docket, and at the October, 1898, term of this Court the cause came on regularly for hearing in this Court, and upon full argument the Court reversed and set aside the decree of the Circuit Court of Appeals for the Sixth Circuit, for the reason that it appeared to this Court that the decree of the Circuit Court for the Middle Division of the Middle District of Tennessee, upon which the appeal to the Circuit Court of Appeals was predicated, was not a final appealable decree. And thereupon the cause was remanded to the Circuit Court of Appeals for the Sixth Circuit with instructions to dismiss the appeal and remand the case to the Circuit Court for the Middle District of Tennessee for further proceedings in conformity with the opinion of this honorable Court, which is officially reported under the name and style of "Guarantee Company of North America v. J. J. Pryor, Assignee," 173 U. S., 587.

In accordance with the decree of this Court, the Circuit Court of Appeals for the Sixth Circuit did on June 10, 1899, reverse its former holding and remand said cause to the Circuit Court for the Middle District of Tennessee, to be further proceeded with in accordance with the decree of this Honorable Court.

Thereupon, upon the 5th day of December, 1899, the Circuit Court for the Middle District of Tennessee made and entered in said cause a decree, the substantial part of which is as follows:

"And thereupon, it appearing that the embezzlements of said Schardt during the currency of his bond as teller and collector is $78,819.24, without interest, and the interest on these various embezzlements from the end of each year to April 17, 1893, is $5,276, and the total of principal and interest is $84,095.35 to April 17, 1893; and it further appearing that the complainant has realized from policies and other sources the sum of $46,828.46, leaving the net amount due from said Schardt as teller and collector, during the currency of said bond, $37,266.89; and it further appearing that the plaintiff is therefore entitled to recover of the defendant the total amount of the penalty of the bond given as teller and collector, viz.: $10,000, with interest thereon from April the 9th day, 1894, to November 9, 1899, making of interest, $3,350 and the aggregate of principal and interest $13,350. And the Court finds that there are no credits to be made upon the bond as cashier and that the plaintiff is entitled to recover the penalty of the said bond, viz., $20,000 and interest from April 9, 1894, to November 9, 1899, amounting to $6,700, making an aggregate of principal and interest of $26,700, and making the total recovery of plaintiff against defendant of $40,050.

"The Court therefore orders, adjudges, and decrees that the Mechanics' Savings Bank and Trust Company, to the use of J. J. Pryor, Assignee, have and recover of the Guarantee Company of North America the said sum of $40,050, together with interest thereon until paid and the costs of the suit, for all of which execution shall issue as at law."

Thereupon by proper proceedings your petitioner removed said cause by appeal to the Circuit Court of Appeals for the Sixth Circuit, and filed therein the following assignment of errors:

I.

IN RE CASHIER'S BOND.

1. The Court erred in not sustaining the defense of a fraudulent and material misrepresentation by which the said bond was procured, such misrepresentation being that the books and ac-

counts of said employee had been examined and found correct December 31, 1892.

2. The Court erred in not sustaining the defense of a suppression of material matters affecting the risk, to wit: the fact that said employee had been known to have engaged in speculation and to have owned an interest in a brokerage concern while the teller of said Bank.

3. The Court erred in holding defendant liable for $5,992.35 of overdrafts by customers of the Bank, because the defendant only contracted to pay losses occasioned by the fraudulent acts of said employee and constituting larceny or embezzlement.

4. The Court erred in holding that said bond was ever in force or ever took effect.

II.

IN RE TELLER'S BOND.

1. The Court erred in not sustaining the defense of a material and fraudulent misrepresentation made by the complainant Bank to procure a renewal of said bond in January, 1892, said misrepresentation being that the books and accounts of the employee Schardt had been examined in December, 1891, and verified.

2. The Court erred in not sustaining the defense of a failure on the part of the Bank to notify the defendant of speculation by said employee during the currency of the bond.

3. The Court erred in not sustaining the defense of the failure of the Bank to cause to be observed all due and customary supervision of said employee to prevent a default during the currency of the bond.

4. The Court erred in not sustaining the defense of the failure of the Bank to make a proper inspection or audit of the books and

accounts of said employee once each year during the currency of the bond.

5. The Court erred in not dismissing the bill as to said bond.

Thereafter, and on the 19th day of March, 1900, said cause was duly heard and after full argument, and on the 24th day of March, 1900, the Circuit Court of Appeals for the Sixth Circuit delivered an opinion in said cause, and entered a decree in all respects confirming the decree of the Circuit Court for the Middle District of Tennessee, with the exception of an item of $5,992.35, "overdrafts allowed but not authorized."

The decree of the Circuit Court of Appeals is as follows:

"This cause came on to be heard on the transcript of the record from the Circuit Court of the United States for the Middle District of Tennessee, and was argued by counsel. On consideration whereof, it is now here ordered, adjudged and decreed by this Court, that the decree of the said Circuit Court in this cause be and the same is hereby affirmed except as to so much of the item of $5,992.35 overdrafts as may have been included in the decree, and so as to limit the recovery on the cashier's bond to $16,971.82 and interest thereon. Costs of appeal to be borne equally by appellant and appellees, and the cause is remanded to the Circuit Court with directions to modify its judgment to the extent indicated."

The only point discussed by the Circuit Court of Appeals in its opinion was that relating to this one item of overdrafts allowed but not authorized, and with the exception of this item adopted and approved its former opinion in this cause, being the opinion upon which the decree was based, and upon which this Court heretofore directed the cause to be brought to this Court upon writ of certiorari, to be here reviewed; and petitioner submits herewith a copy of said opinion as a part of this petition. See also 47 U. S Appeals, 91.

A certified copy of the entire record of the said case in said Circuit Court of Appeals is herewith furnished and hereto annexed

as part of this application, in conformity with rule 37 of this Honorable Court, relative to cases from Circuit Courts of Appeals.

Your petitioner is advised that the said decree of the said Circuit Court of Appeals in the said case is erroneous, and that this Honorable Court should require said case to be certified to it, for its review and determination under and in conformity with the provisions of the sixth section of the Act of Congress, entitled "An Act to establish Circuit Courts of Appeal, and to define and regulate, in certain cases, the jurisdiction of the Courts of the United States, and for other purposes," approved March 3, 1891, the decree in said case being made final in the said Circuit Court of Appeals by the said Act.

Petitioner shows to the Court that the business of guaranteeing the fidelity of persons in positions of trust is of recent origin. It is the last phase of the insurance business to be developed to widespread extent. The business has, in the last few years, expanded very rapidly. At first confined to guaranteeing the fidelity of employees of railroad companies and banks, it has now extended to the making of bonds for every class of persons in positions of trust, in whatsoever manner named or appointed. Many of the largest employers of such persons now require such a bond as a condition of employment. Within the United States there are now fifteen companies, with a capital of $7,804,600, engaged in the business. Their total premium receipts for the year 1896 were $3,138,848. The total number of bonds issued was about 450,000, and the total amount of risk thereunder was $671,548,077. New companies are constantly organizing, and the business of making such bonds is steadily growing. So far as petitioner has been able to find, this is the first case arising in the Courts of the United States involving not only the disclosures required of persons seeking such bonds of indemnity in making application therefor, and the effect of misrepresentations made in such applications, but also involving the general rules which will govern the Court in consid-

ering the conditions and requirements of the bonds issued regarding supervision of the employer over the bonded employee. This suit presents fully the questions concerning the relations of the parties before and after the making of such bonds.

Petitioner shows to the Court that it is of the greatest moment and importance, not only to the companies, which have so large an amount at risk, but also to the employers who seek and procure such bonds, that there shall be an authoritative decision of the principles of law which govern the parties, both in the procuring of such bonds and in their relations to each other after their issuance and while they continue in force. If the holding of the Circuit Court of Appeals in this case that the employer, in seeking such bond, is not bound to make disclosure of such facts as may be known to him affecting the reliability of the employee sought to be bonded, even when asked in regard thereto by the bonding Company, and that an answer which can by any possibility be excused as not being in bad faith, shall not be deemed a misrepresentation avoiding the bond, and that, after procuring such a bond, the employer is bound to no duty and to no diligence in regard to a supervision of the employee, and all stipulations looking toward requiring the disclosure of discrediting facts known to the employer, either at the time of the issuance of the bond or becoming known to him thereafter, or stipulations regarding the supervision of the employee, are to be construed against the Company with the utmost strictness and harshness, shall be sustained and become the law of the land, it will have the effect to greatly increase the hazard and risk of the business to the companies engaged therein, will cause them heavy losses on bonds already in force, and will result in the permanent injury and loss of the public seeking such bonds, by requiring large increases in the premiums paid therefor, to cover the additional hazard and risk so incurred. It is therefore of the gravest importance to such companies and to the persons procuring their policies to have an early determination of the questions involved in this suit by this Hon-

orable Court, which, by reason of its authority in the United States Courts, and by reason of the comity of the Courts of the several States, will become the recognized rule of decision in all of the Courts of the United States and of the several States.

The said Circuit Court of Appeals, in laying down the principles which should govern the trial of suits on the bonds of suretyship—such as were issued by petitioner in this case—and in announcing the principles which would govern them in deciding the present case, used the following language in its opinion:

> In marine, fire, and life insurance it is not an unreasonable assumption that the owner knows more intimately than others can know the conditions which are material to the risk assumed, and it is therefore not unreasonable to require him to disclose those conditions to the insurer and to hold him strictly to that duty. But in an insurance like this the insurer and the insured deal at arm's length with each other and upon a plane of equal opportunity for information. Indeed, the risk does not depend so much on conditions of fact as upon a mere judgment about human character in the subject of the insurance — his individuality of moral qualities. About this the insurer can inform himself and the assured is not presumed to know anything, as in the case of the owner of a property or a life which has been insured. Hence it is not unreasonable to hold the insurer to his risk in the broadest sense that is required to indemnify the assured for any loss by dishonesty which falls fairly within the employment of the person whose honesty is guaranteed, and to permit no escape except by lines of retreat or avenues of deliverance clearly defined, well marked, and mutually understood as part of the contract—evidenced by the use of unambiguous language for that purpose.
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> And we wish further to remark that the business honesty or fidelity insured by such contracts as these is not that kind of enforced honesty which comes of a want of opportunity to be dishonest, but that which is to be sturdy enough to operate for safety, spite of opportunity and temptation. That is the only kind of insurance worth the premium paid by the assured or which is a fair consideration for the risk of loss which he opens under the protection of the guaranty, and, in the absence of evidence to the contrary, presumably that which is bargained for in each instance. A kind of honesty which will not take advantage of lapses of watch-

fulness to construct deceitful appearances adjusted to familiar traits or habits of carelessness on the part of the employer, perhaps indulged because of reliance upon the insurance which has been accepted as a protection. An employer would need no insurance against that close and relentless vigilance which makes stealing impossible, and under these contracts he is bound to no watchfulness except that which he has contracted to use, in plain words, for the benefit of the insurer.

The old form of bond and security was usually without covenants for watchfulness or inspection by the employer, or other obligee, and as that is the highest measure of liability of which the business is capable it is that which the obligee would naturally seek for his protection, always desiring presumably to provide by some such guaranty even against his own negligence and careless business habits. The nature of the risk forbids the idea of any implied or general limitations upon the guaranty against loss by dishonesty, and in our judgment, these contracts are not to be construed as imposing any by mere inference of an understanding between the parties that the business will be conducted with either ordinary or any degree of diligence or prudence as to watchfulness. The insurer gets what he contracts for in respect of that and nothing more, and he must provide by express stipulation for even ordinary prudence on the part of the assured in taking measures for minimizing or lessening the broad risk we have indicated as that most desirable to the assured, and, therefore, that which is intended to be covered by the words of insurance in these contracts; except so far as the "provisos and conditions hereinafter contained" shall have limited that broad liability. Nothing is to be implied not necessarily indicated by the words used, as might be in other examples of insurance where the relation of the parties and the character of the risk are different and where those relations properly breed implications that would import a meaning not admissible when the thing guaranteed is so far disassociated from any duty owing by the assured to the insurer as we find in the subject-matter of insurance here.

Petitioner now shows this Honorable Court that the Circuit Court of Appeals, in laying down the principle that the rules governing companies carrying on a suretyship business should be stricter and harsher than those applied in cases of contracts of marine, fire, and life insurance, acted on a false and untrue assumption, to wit: that companies engaged in such business could pos-

sess themselves of fuller information about the subject of the risk than marine, fire, and life insurance companies could about property or life on which insurance had been solicited. It is true that when an employee has, before his employment, been unknown to the person employing him, his employer seeking a bond and the Company of which such bond of suretyship is sought would have an equal opportunity of securing information concerning him, as to the factors which would enter into and determine the risk incurred by becoming such surety. But it is untrue that such Company would possess means of information equal to those of the employer, where the person on whom the bond is sought has been for years in the service of the employer, as said Schardt had been when the Mechanics' Savings Bank and Trust Company applied for the issuance of a bond on him as cashier.

Your petitioner, and the other companies engaged in a like business, have, by years of experience and observation, been able to determine the causes that ordinarily lead an employee in a position of trust to peculate. They have found that persons in positions of trust who speculate in stocks, grain, cotton, provisions, and like commodities, invariably, lured on by the hope of retrieving past losses, become defaulters to large amounts. They have further found that persons in positions of trust who are in the habit of gaming will, sooner or later, become losers, and, in consequence, defaulters, though the defaults consequent on such misconduct are not nearly so large as those resulting from speculations involving sums far greater than those at risk on games of hazard. They have found that when an employee has once yielded to temptation and defaulted, he is likely to again default. They have found that persons in positions of trust who lived beyond their income are likewise greatly exposed to the temptation of small peculation, particularly if addicted to immoralities and other excesses. They have further found that the risk is very much increased by the employee who is handling money being harassed by debt. They have found that a man's daily habits and associations determine very

largely the likelihood as to whether or not he will continue the faithful discharge of his duties. They have further found that outside of and beyond these personal elements, the character of the supervision over the employee for the prevention of default, and the probability or improbability of an early discovery of any shortage is a factor of the highest importance in determining whether or not it is likely that an employee will be guilty of his first embezzlement.

On all these points which alone enter into and determine whether or not a bond of suretyship shall be granted in the first instance, and, after it has been granted, whether or not it shall be continued, the employer in whose service an employee has continued for a long time is infinitely better able to know than any surety company applied to for a bond. It is to such employer that the Company must go for information as to the daily habits and associations of the employee, his former fidelity in the discharge of his duties, his habits of personal extravagance, causing his expenditures to exceed his income, and particularly whether or not he is addicted to gambling or speculation. Such employer alone can know what is to be the nature of the supervision over the employee for the prevention of default, and it is to the employer that such a Company must look for information in regard thereto.

Your petitioner, therefore, avers that no harsher or stricter rule should be applied in such cases than is applied in cases of other insurance, and particularly in cases of marine and fire insurance, which are very similar to suretyship or guarantee insurance in regard to the opportunities of information concerning the risk incurred. Petitioner further avers that the rules governing life insurance should be administered even more strictly than in suretyship insurance, for the reason that controversies regarding life insurance, involving the representations made to procure it, and the covenants regarding acts to be done on the part of the person whose life is insured, ordinarily does not arise until after the death of the person whose life is insured, and his representatives are cut

off from the benefit of his testimony. In the case of suretyship insurance, when a claim for a loss has been made both parties stand on an equal footing regarding their knowledge and ability to testify as to the representations made and the performance of the covenants put on the person holding the insurance.

In life and fire insurance, the insured is frequently ignorant and unused to dealing with a more experienced man, able to take advantage of his ignorance. It frequently happens that, in such insurance, the insured is financially weak and carries on an unequal struggle with an opulent opponent. In suretyship insurance, as a rule, the contrary is true. Persons and managers of corporations seeking such insurance are usually shrewd business men, abundantly able to take care of themselves in contracting, and ordinarily careful to know the terms of a contract and scrupulous to see that they fulfill their part. In any suit that may arise with a Guarantee Company they have ample resources so as to leave nothing in their favor undeveloped.

Your petitioner now shows that, under the evidence hereinbefore cited, the said Circuit Court of Appeals, in its statement of the case, which was a part of its opinion disposing of the cause, found and ascertained the following to be the facts:

It is in evidence that information came to the president and directors of the Bank through their cashier that Schardt was a partner in what is called "a bucket shop," an agency for promoting speculation in small amounts upon the fluctuations of stocks, grain, cotton, and other commodities in which speculative gambling is done, and that he himself was speculating. When charged with this Schardt admitted that he had taken an interest in such a partnership, but that he had sold out. He called his former partners to confirm his statement in this regard. He also admitted, according to one of the witnesses, at another time, that he had speculated to some extent, but asserted that he had always made gains and had seen the error of his ways and had stopped. Subsequently the cashier received an anonymous letter stating that Schardt was still speculating. He informed the president of the Bank. Schardt said it was a lie, and no more attention was paid to it. All this occurred prior to the time when the president signed the guarantee proposal for the cashier's bond referred to.

As a matter of fact Schardt was speculating all the time, and lost the $100,000 he had stolen in gambling in futures.

This Honorable Court, in the case of *Prather* v. *Preston,* reported in 137 U. S., 604, said in regard to the effect which information and knowledge that an employee in a position of trust has been speculating should have on his employer:

"In *Scott* v. *Bank, 72* Pa. St., 479, 480, the Supreme Court of Pennsylvania asserted the same doctrine as that in the Massachusetts case, holding that a bank, as a mere depository, without special contract or reward, was not liable for the loss of a government bond deposited with it for safe keeping, and afterwards stolen by one of its clerks or tellers. In that case it was stated that the teller was suffered to remain in the employment of the bank after it was known that he had dealt once or twice in stocks, but this fact was not allowed to control the decision, on the ground that it was unknown to the officers of the bank that the teller gambled in stocks until after he had absconded, but at the same time observing that 'no officer in a bank, engaged in stock gambling, can be safely trusted, and the evidence of this is found in the numerous defaulters whose peculations have been discovered to be directly traceable to this species of gambling.'

"A cashier, treasurer, or other officer having the custody of funds thinks that he sees a desirable speculation and takes the funds of his institution, hoping to return them instantly, but he fails in his venture, or success tempts him on, and he ventures again to retrieve his loss or increase his gain, and again and again he ventures. Thus, the first step, often taken without a criminal intent, is the fatal step, which ends in ruin to himself and to those whose confidence he has betrayed. As stated above, the reasonable care which persons should take of property intrusted to them for safe keeping, without reward, will necessarily vary with its nature, value, and situation, and the bearing of surrounding circumstances upon its security. The business of the bailee will necessarily have some effect upon the nature of the care required of him—as, for example, in the case of bankers and banking institutions having special arrangements, by vaults and other guards, to protect property in their custody. Persons, therefore, depositing valuable articles with them expect that such measures will be taken as will ordinarily secure the property from burglars outside and from thieves within, and that, whenever ground for suspicion arises, an examination will be made by them to see that it has not

been abstracted or tampered with; and also that they will employ fit men, both in ability and integrity, for the discharge of their duties and remove those employed whenever found wanting in either of these particulars.

"An omission of such measures would, in most cases, be deemed culpable negligence, so gross as to amount to a breach of good faith, and constitute a fraud upon the depositor. . . . . Upon this subject the Court below, in giving its decision (29 Fed. Rep., 498), after observing that the defendants knew that Ker had been engaged in a business which was hazardous, and that his means were scant, and after commenting upon the demoralizing effect of speculating in stocks and grain, as seen in the numerous peculations, embezzlements, forgeries, and thefts, plainly traceable to that cause, and the free access by Ker to valuable securities, which were transferable by delivery, easily abstracted and converted, and yet his being allowed to retain his position without any effort to see that he had not converted to his own use the property of others, or that his statements were correct, held that it was gross negligence in the defendants not to discharge him or place him in some position of less responsibility. In this conclusion we fully concur."

Your petitioner, in the argument of the cause before the said Circuit Court of Appeals, had drawn its attention to the language of this Honorable Court in the case of *Prather* v. *Preston.* Said Circuit Court of Appeals, in its opinion, said that it agreed to all that had been said in the opinion in that cause, but, inasmuch as it did not appear that the failure to take cognizance of this speculation on the part of said Schardt, or to make report of it to your petitioner, then a surety on his bond as teller, or to communicate it to your petitioner when applying for a bond on said Schardt as cashier, was the result of bad faith on the part of any of the officers of the Bank, but only bad judgment in not being more affected by their information, held that it did not bar a recovery on the two bonds, and in regard thereto used the following language:

"But this defendant Company had not contracted for such a guaranty against negligence as had the depositors and bailees who sustained an action of damages in those cases, and this suggested analogy is neither a legal nor a fair test of the contract duty of the Bank to its insurer against Schardt's dishonesty in the premises. Here, again, it must be strictly limited to the words it has used in

defining that duty, and none is owed beyond the words by any kind of implications energized by any indignation at the negligence of the bank in not protecting itself, or indignation at the immoral conduct of Schardt. This insurer was insuring the Bank for its protection in just such emergencies and against just such negligence, unless the words of this policy speak to the contrary, and had received the consideration for it, while the depositors in the Bank, in the cases cited, had contracted for either common prudence, ordinary vigilance, or against gross negligence. It is a reversion of the attitude we have here, and it is a perversion of that principle to apply it here."

Then, proceeding to construe such bond as teller, which had expressly stipulated that "the employer shall at once notify the Company on its becoming aware of said employee being engaged in speculation or gambling, or indulging in any disreputable habits or pursuits," the said Circuit Court of Appeals held that inasmuch as when said Schardt had admitted his part ownership in a "bucket shop," and that he had been speculating, he claimed he had sold his interest in the "bucket shop" and had ceased to speculate, the Bank was not bound to give notice of the fact so coming to its knowledge, because it was a "past event," and that it would be held to the duty of giving notice of such speculation, gambling, disreputable or unlawful habits or pursuits only when he was engaged therein at the very instant and time of discovery. Your petitioner submits that by a fair construction of the words used in the stipulation for its protection, said Bank was bound to report its knowledge so obtained, even though said Schardt claimed that he had sold out his interest in the "bucket shop" and had ceased to speculate. Said Circuit Court of Appeals further held that, being a partner or stockholder in a "bucket shop" was not speculation or gambling, or engaged in it, *but only being the agent of those who were speculating and gambling.* The Court so held, notwithstanding it is a fact so widely and generally known that all Courts will take judicial notice thereof, that a brokerage business is one of agency where the broker takes the order of the person speculating and has it executed through a member of some one of the stock,

grain, or cotton exchanges, the member of such exchange through whom he deals securing either the profit or making good the loss to the broker's customer, while the broker, for compensation to himself, receives a small commission on the sale. In a "bucket shop," however, the orders are not executed on any exchange, but the "bucket shop" settles with persons dealing with it according to the rise or fall of the thing dealt in. It is the proprietors of the "bucket shops" who become the principals in the wager with the customer.

The said Circuit Court of Appeals further held that, should the Bank become aware of any disreputable habit or pursuit, and it was claimed the habit or pursuit had been abandoned, it was not bound to give notice thereof to the Company.

In the application for the cashier's bond, as hereinbefore set out, the president of the Mechanics' Savings Bank and Trust Company was asked, "Have you known or heard anything unfavorable as to his (the said Schardt's) habits or associations, past or present? Or of any matter concerning him about which you deem it advisable for the Company to make inquiry?" To both of said questions, said president had answered "No." Said Circuit Court of Appeals held, under the evidence hereinbefore cited, it did not appear that the said Baxter in bad faith withheld the information possessed by him; and, if in good faith, he did not believe what he heard to be unfavorable, because Schardt had ceased to speculate and had sold his interest in the "bucket shop," or in like good faith did not deem it advisable that the insuring Company should make inquiry, his answer was true, but he was made the judge of what was unfavorable or what was advisable. The Circuit Court of Appeals furthermore said that it doubted if dealing in futures or speculating would be considered as embraced in the question asked, and that, for an employee to be given to dealing in futures and to be speculating, would not be considered an unfavorable habit or association. The Court held finally, and repeated, that the quality of being unfavorable or advisable was

left open to construction by the mind of him who was answering the question, and assumed that the mind of said Baxter had so construed it. It appears from the transcript that said Baxter is living, and could have been called as a witness on behalf of the said assignee, but, for some reason, he was not called by him, nor was any explanation given of his failure to do so.

Your petitioner now shows to this Honorable Court that the opinion of said Circuit Court of Appeals is in irreconcilable conflict with the holding of this Court in the case of *Prather* v. *Preston.* The public interest demands that the authority of *Prather* v. *Preston* shall in nowise be diminished or impaired, and the effect of the holding of said Circuit Court of Appeals in the present case is to say that the superiors of employees in positions of trust, who are found to be speculating, are not, in all cases, bound to institute an immediate examination of their accounts, and to dismiss them from the position where they have an opportunity to wrongfully possess themselves of money for the continuing of their speculations, but that they can, at least so far as guarantee companies are concerned, continue them in their positions, without an examination of their books, hold them out as worthy of confidence, and secure guarantee insurance to whatever amount they may desire, and so place on such companies the losses which come from the defaults they will in all likelihood commit.

Petitioner further shows that during the whole of the time it was the surety of said John Schardt to said Mechanics' Savings Bank and Trust Company, there were kept in the Bank the accounts of the Bank with its individual depositors in two large books. These books were kept by one Frank Boensch, known as individual bookkeeper. With the keeping of these books said Schardt had nothing to do. There were, in addition, three general books, all kept by said Schardt: (1) a general ledger, showing generally the accounts of the Bank, including the total deposits, but not in detail the accounts of the depositors. It purported to

show the general deposits paid in and those checked out each day, and purported to show each day the aggregate amount due to depositors. It showed a statement of the demand loans, discounts, bonds, stocks, etc., owned by the Bank. (2) A cash book, showing day by day the entire business transacted on any particular day. For each day the account would begin with the cash on hand at the opening of the Bank on that day, and would be debited with all the receipts for the day, showing from what source derived, and would be credited with all disbursements, showing on what account made. (3) A daily balance book, showing a summary of each account in the general ledger, and showing at the end of each day's business all the assets and liabilities of the Bank under appropriate headings. Thus, it showed the amount of cash, notes, stock, bonds, etc., owned by the Bank, and the amount the Bank owed depositors, other banks, bills payable, etc.

It was found by said Circuit Court of Appeals, and stated in its opinion:

While Schardt was teller he kept the general ledger and the cash book, and made the daily statement of the bank. A clerk kept the individual ledger. The individual ledger was correctly kept. Whenever Schardt abstracted money from the deposits, he would place the items correctly in the cash book, but he would make false totals less by the amount he had taken than the true total, and these false totals he would transfer to the individual deposit account on the general ledger. Until 1890 it had been the practice in the Bank every month to take trial balances of the individual ledger accounts and verify the balances thus shown with those of the general ledger. Schardt directed the clerk to discontinue this, and thereafter, from 1890 until the collapse of the Bank no balance was ever taken from the individual ledger, and no comparison was ever made between Schardt's balances as shown by the general ledger and those which could have been shown by the individual ledger. These two ledgers were out of balance $2,098 January 16, 1891; $19,600 January 1, 1892, and $69,700 January 1, 1893. The discrepancies were caused by Schardt's embezzlement of the deposits. In addition to this amount, Schardt embezzled $3,765.44 in the year between January, 1891, and January, 1892, and $4,015.44 in the year between

January 1, 1892, and January 1, 1893, of money received by him from the proceeds of notes due the Bank and in his custody for collection. The finance committee of the board of directors of the Bank made quarterly examinations of the Bank. These examinations consisted of checking over a statement made by Schardt of the condition of the Bank with the notes and securities and cash which he produced, and with statements from other banks of credit balances. There is some doubt as to whether the finance committee saw the cash book or what purported to be a copy of a statement taken from it.

The undisputed and uncontradicted evidence, both of the witnesses for petitioner and of the witnesses on behalf of the assignee, showed that it was customary in all banks, whether large or small, to compare, at least once a month, the amount shown to be due to individual depositors by the ledger of individual deposits with the amounts shown to be due depositors by the general ledger and the daily balance book. The said Circuit Court of Appeals made no finding in regard to the conclusion established by said evidence, but said in regard thereto:

Much proof was taken to show what kind of supervision is ordinarily and prudently taken by other banks and generally in the banking business to prevent default, it being assumed that there was a contract here for that kind of supervision, or at least that which ordinary prudence in any business would require. Certainly these words may mean that but not necessarily. They may mean less. For example, they may mean that "due and customary supervision," which obtained in this particular Bank, not over all employees, but over the teller; not over all its business in every direction, but only over that which he did. It may mean that which was in vogue when the contract was made, or that coming subsequently into use as affording a better mode of detection. If that supervision which was customary for the authorities of this Bank to keep over the teller was careless and ineffective for detection, it would be none the less "due and customary," and that which they took "to prevent default."

. . . . . .

The words of either of the bonds we have quoted are ambiguous and may embrace any degree or acts of supervision, from the highest and most certainly effective to those which are at least so, as long as they were "customary" or "due." The standard of ex-

cellence or efficiency is not definitely mentioned, nor is any rule of custom definitely prescribed, whether of this Bank or of all banks, or of any business in which cashiers and tellers are employed. By the rule we have laid down, the defendant company should have been more specific in defining the supervision they required, and the contract should have added, if that was the intention, all due and customary supervision in use in the best-managed banks or generally in use by banks conducted with ordinary prudence and skill, or some words sufficiently designating the general custom now sought to be relied on — if there were at that time any such general custom prevailing in the management of banks; not words applicable to any prudent supervision in many differing ways, but those pointing out a custom of supervision in the particular way now insisted upon.

Said Circuit Court of Appeals, in its opinion, under authority of two cases adjudged by this Court *(Goddard* v. *Foster,* 17 Wall., 123, and *Insurance Co.* v. *Wright,* 1 Wall., 456), held that parol evidence of usage or custom was not admissible to vary, control, or contradict an express contract; but, inasmuch as when the Mechanics' Savings Bank and Trust Company, when applying for a bond on John Schardt as teller, was asked, in its application, by your petitioner, "What is your *custom* in regard to the frequency of inspections? Are they at stated intervals or irregular, and what is the longest time allowed to elapse between inspections?" and answered, "Every quarter," it was the duty of the Court, in accordance with familiar general rules of technical interpretation, to read those words, "due and customary," in the light of that question and answer, and to hold that such quarterly inspection was the due and *customary* supervision referred to in these bonds and provided for by the contract; and your petitioner having thus expressly contracted as to the "custom," could not be permitted to show what in all other banks was considered due and customary supervision for the prevention of default.

In disposing of the further defense interposed by petitioner, that the renewal of the teller's bond for the year 1892 was procured by the false statement contained in the certificate of the Bank that

the accounts of said Schardt, up to the first of January, 1892, had been examined and verified, when, in fact, they had been neither examined nor verified, and such examination or verification would have at once disclosed the existence of the default, said Circuit Court of Appeals held as follows:

However careless the examination may have been, if made in good faith and the examiners believed the accounts correct, they might truthfully so represent them, albeit they were not correct. The position of the defendant Company leaves no margin here, and holds the Bank to absolute truthfulness, not of the fact of examination made in good faith and a belief in correctness, but of the soundness of Schardt's entries and accounts and their freedom from fraud, no matter how skillfully a fraud may have been concealed by him. The facts do not show any such intentional representation, and the words do not define such a complete assurance. The words "correct" and "verified" may mean that but also less in any degree. One "verifies" an account by merely adding up or doing the other work of mathematical calculation and finding the figures correct or by such comparison of entries and items as one may make and find "correct," and any extent of this is "examination," however superficial. These representations do not say that the examination was skillful or extensive or by comparison of books and trial balances, but only that such examination as was made disclosed no error or fraud, and if this was done in good faith, as there is no doubt it was, it fully meets the representations made unless we are to imply that the parties intended such a thorough examination as would save the insurer harmless, and this, we think, was not contracted for in plain and unambiguous language, as it might have been, if intended.

Petitioner shows that the substance of the holding of said Circuit Court of Appeals was that a surety company, in the absence of stipulations in respect thereof, was not entitled to have any degree of supervision kept over the employee for the prevention of default; and if a stipulation should be made regarding such supervision, the words used were not to be taken in their plain and ordinary sense and acceptance, but were to be construed against the surety company with the utmost harshness, and if an examination, however loose, could by a construction, however strained, be made to satisfy the letter of the bond, it should be deemed sufficient.

The reason stated by the Court is that such bonds of indemnity are sought for the purpose of enabling bank officials to be able to relax their vigilance, and to feel secure because they hold such indemnity.

Your petitioner shows that such a view wholly mistakes the purpose and scope of such insurance. No vigilance, however great, no supervision, however strict, can entirely eliminate the possibility of peculation on the part of the employee. There comes an interval between all examinations, when an embezzlement can not by any possibility be prevented. With every examination, however strict and thorough, there is a manipulation possible by which a default can for a time be covered up. Such bonds are sought not for the purpose of rendering examinations useless, and not for the purpose of being able to relax the supervision over the employee, but for the purpose of covering this element of chance of an embezzlement which no foresight and no care can guard against. Such insurance is never sought for an amount equal to the sum to come into the hands of the employee, or the amount of a possible embezzlement. In the present case, notwithstanding Schardt had the opportunity to, and as teller did, embezzle exceeding $70,000, yet the penalty of the bond was for only $10,000. In the present case it can not be said that the bond was procured for the purpose of enabling the Bank officials to relax the vigilance of their supervision over its teller, for the reason that the amount of his possible embezzlement was many fold the penalty of the bond, and the amount of his actual embezzlement was seven-fold its penalty.

Your petitioner shows that it would be contrary to public policy, and greatly detrimental to the public interest, for the rule to be established that the officials of corporations can dispense with all care in overlooking employees under them if they hold a bond for a fraction of the amount which they might embezzle.

Your petitioner shows that the present judgment of the Circuit Court of Appeals has excused a negligence that has gone to the

extremest possible limit. For three years the ledgers of the Bank were out of balance, for a long time in an amount exceeding the capital stock of the Bank, and a comparison of these, such as is customary in all other banks every thirty days, and was customary in this Bank until just before the default commenced, would have in an instant disclosed the existence of such shortage and its approximate amount. For three years the notes in the hands of the teller and cashier did not correspond with the notes a list of which was found in the general books, and a comparison of them at any time within the last three years of Schardt's connection with the Bank would have disclosed such shortage and its amount. Such a comparison is the first principle of every examination.

In fact, said Circuit Court of Appeals, in its opinion as first prepared and printed, said:

"We concede that it is difficult to see how the officials of this Bank could have failed, by ordinary prudence, to have discovered these frauds, or how, without some negligence, the losses could have occurred. But it does not follow from this that this Company, which has guaranteed to the Bank and its stockholders the fidelity of the teller and cashier, can escape its liability because of such negligence."

When the opinion was filed with the clerk of the Circuit Court of Appeals, on April 29, 1897, as may be seen from page 13 of the opinion, as found in the transcript accompanying this petition, the sentence just quoted was changed to read as follows:

"If we were to concede that the officials of this Bank could not have failed, by ordinary prudence, to have discovered these frauds, or that without some negligence the losses could have occurred, it would not follow from this that this Company, which has guaranteed to the Bank and its stockholders the fidelity of the teller and cashier, can escape its liability because of such negligence."

This Honorable Court, in *Briggs* v. *Spaulding*, 141 U. S., 132, said:

"We hold that directors must exercise ordinary care and prudence in the administration of the affairs of a bank, and that this includes something more than officiating as figure-heads. They are entitled under the law to commit the banking business, as defined, to their duly authorized officers, but this does not absolve them from the duty of reasonable supervision."

Not only was the Bank bound to exercise such a reasonable supervision, through its board of directors and its finance committee, but it was bound to exercise a stricter and more rigid supervision through its president and cashier, salaried officers constantly at the Bank, and the supervisors of said Schardt so long as he was teller.

Petitioner is advised that as a matter of law such duty of reasonable supervision was imposed on the officers and directors of the Mechanics' Savings Bank and Trust Company, and that duty was in favor of every person who would be injured by its neglect, including the surety on the bond of its officers handling its cash and funds. Petitioner is further advised that particularly was this duty owed to it, as it was expressly stipulated for in the bonds, and the holding of the said Circuit Court of Appeals is in irreconcilable conflict with the holding of this Honorable Court in *Briggs* v. *Spaulding*.

Finally, petitioner shows that whatever may be the rule of construction of the provisions of the bonds regarding supervision, and however forced the meaning given to the words, there is no possible construction which does not involve a violation of its duty and agreement on the part of the Mechanics' Savings Bank and Trust Company. Whether the words mean the kind of supervision that is ordinarily and prudently taken by other banks, or generally in the banking business, or that which obtained in this particular Bank, either over all its employees or over the teller, or over its business in every direction, or over that which the teller did, or that in vogue when the contract was made, or that subsequently coming into use, in each and every case which the ingenulty of the

judge delivering the opinion was able to suggest, there was not, on the part of the Bank, that supervision it agreed to exercise.

Wherefore, your petitioner respectfully prays that a writ of certiorari may be issued out of and under the seal of this Court, directed to the United States Circuit Court of Appeals for the Sixth Circuit, commanding said Court to certify and send to this Court, on a day certain, to be therein designated, a full and complete transcript of the record and all the proceedings of the said Circuit Court of Appeals in the said case therein, entitled: "The Guarantee Company of North America, Appellant, v. The Mechanics' Savings Bank and Trust Company, for the use of J. J. Pryor, Assignee, etc., Appellee," No. 792, to the end that said case may be reviewed and determined by this Court, as provided in the sixth section of the Act of Congress entitled, "An Act to establish Circuit Courts of Appeal, and to define and regulate in certain cases the jurisdiction of the Courts of the United States, and for other purposes," approved March 3, 1891, or that your petitioner may have such other or further relief in the premises as to this Court may seem appropriate, and in conformity with said Act, and that the said decree of the said Circuit Court of Appeals in the said case may be reversed by this Honorable Court.

And your petitioner will ever pray, etc.

GUARANTEE COMPANY OF NORTH AMERICA,
By WILLIAM L. GRANBERY,
Solicitor and Counsel for Petitioner.

STATE OF TENNESSEE,
DAVIDSON COUNTY. } *ss.*

Theo. Cooley, being duly sworn, says that he is the general agent for the Southern Department of the Guarantee Company of North America, the petitioner above named, and as such has had personal charge for it of the case mentioned in the foregoing peti-

tion in the Circuit Court of the United States for the Middle District of Tennessee, and in the United States Circuit Court of Appeals for the Sixth Circuit; that he has read the foregoing petition, and the facts therein stated are true to the best of his information and belief.

THEODORE COOLEY.

Sworn to and subscribed before me April 18, 1900.

CHAS. C. TRABUE,
Notary Public.

NASHVILLE, TENN., April 18, 1900.

I, Edward H. East, solicitor for Mechanics' Savings Bank and Trust Company for the use of J. J. Pryor, Assignee and apellee, hereby acknowledge notice of the within application for a certiorari and agree that the same may be presented at the convenience of appellant, the Guarantee Company of North America.

MECHANICS' SAVINGS BANK AND TRUST CO.,
for use of J. J. Pryor, Assignee.

By EDWARD H. EAST,
Solicitor.

APPENDIX.

UNITED STATES CIRCUIT COURT OF APPEALS,

SIXTH CIRCUIT.

THE GUARANTEE COMPANY OF NORTH AMERICA,
Appellant,

v.

THE MECHANICS' SAVINGS BANK & TRUST COMPANY,
For the use of James J. Pryor, Assignee, Appellee.

No. 349.

Appeal from the Circuit Court of the United States for the Eastern District of Tennessee.

SUBMITTED DECEMBER 12, 1895. DECIDED OCTOBER 5, 1896.

BEFORE TAFT AND LURTON, CIRCUIT JUDGES, AND HAMMOND, DISTRICT JUDGE.

This was a bill in equity filed in the Chancery Court of Davidson County, Tennessee, by the assignee for the benefit of creditors of the Mechanics' Savings Bank and Trust Company, against the Union Bank and Trust Company, administrator of John Schardt, deceased, a corporation of Tennessee, and the Guarantee Company of North America, a corporation of Canada, to state an account between the bank and John Schardt, its deceased cashier and teller, to obtain a decree properly applying certain credits to the debt in favor of Schardt, and to recover the balance found to be owed by Schardt to the Bank, from the Guarantee Company on two bonds or fidelity insurance contracts entered into by Schardt and the Guarantee Company with the Bank, indemnifying it from loss by the dishonesty of Schardt, one covering his dishonest acts while he was teller of the Bank, and the other for his dishonest acts while he was its cashier. The Guarantee Company removed the cause to the Court below on the ground that there was in the

case a separable controversy between the complainant, a citizen of Tennessee, and the Guarantee Company, an alien corporation. The bonds sued on were joint and several obligations of Schardt and the Guarantee Company. Schardt's administrator demurred to the bill for want of equity in the State Court, and the record shows no further proceedings against it. No motion to remand was made, and the cause proceeded in the Court below against the Guarantee Company alone, the two parties stipulating that the cause should be heard in equity, or if removed to the law docket, that a jury should be waived and trial had to the Court.

Schardt was teller of the Bank from January 16, 1888, until January 1, 1893. He was cashier from January, 1893, until his death, April 17, 1893. The bond covering his acts as teller was given in 1888 for a year, and was renewed from year to year until January, 1896, when a new bond, covering his acts as cashier, was given. The teller's bond recited that the bank had delivered to the Guarante Company a certain statement, and that it was agreed and understood that the statement constitued an essential part of the contract of indemnity. In consideration of $100 a year, the Company then agreed to make good and reimburse to the employer such pecuniary loss as the employer shall have sustained by the fraudulent acts of the employee in connection with the duties of his said office or position or with any other duties assigned to him by the employer in the said service, committed by him and discovered during the continuance of this bond and within six months from the employee's ceasing to be in the said service. The bond provided further that:

"The following provisions are also to be observed and binding as a part of this bond: That this bond is issued and renewed on the express understanding that the employee has not, within the knowledge of the said employer at any further period either in this or other employment been guilty of any default or serious dereliction of duty.

"That the employer shall observe or cause to be observed all due and customary supervision over the said employee for the prevention of default, and if the employer shall at any time during the

currency of this bond condone any act or default on the part of the employee, which would give the employer the right to claim hereunder, and shall continue the employee in his service, without notification to the Company, the said Company will not be responsible hereunto for any default which may occur subsequent to said act or default of said employee so condoned.

"That the employer shall at once notify the Company on his becoming aware of the said employee being engaged in speculation or gambling or indulging in any disreputable or unlawful habits or pursuits.

"That there shall be an inspection or audit of the accounts or books of the employee on behalf of the employer at least once in every twelve months from the date of this bond.

"That the Company shall not in anywise be responsible to the employer under this bond to a greater extent than ten thousand dollars."

By another provision Schardt agreed to keep the Company harmless from any payment it might have to make under the bond. The bond is signed by Schardt, the Guarantee Company, and the Bank.

The statement referred to in the bond contained twenty questions and answers concerning the Bank's knowledge of Schardt's integrity and past business life, the character of supervision to which he was subjected in discharging his duties and the salary paid him. Of these the following only are material here:

7. When was the last inspection of the office at which he was stationed made?

A.—December 24, 1887.

8. What is your custom in regard to the frequency of inspections? Are they at stated periods or irregular, and what is the longest time allowed to elapse between inspections?

A.—Every quarter.

9. Has the Bank a duly appointed and authorized inspector or inspectors? If not, by whom are the inspections made?

A.—The finance committee.

. . . . . .

18. In the event of the employer filling the post of teller, how often and by what officer will the teller's cash be checked and counted?

A.—By the finance committee; quarterly.

At the end of each year of the bond, the Bank received the following notice:

"It is necessary, before the bond can be renewed, that you obtain the certificate on the back hereof by your president or cashier, and on its return with the remittance of the premium, the renewal can be immediately effected."

The certificate was accordingly filled up and signed by the cashier of the Bank at each renewal. Among other things it stated that the accounts of Schardt, the teller, had been examined and verified by the finance committee of the Bank. On such certificate the bond was renewed.

The cashier's bond was given in January, 1893. By its terms Schardt and the Company, the latter relying on a certain guarantee proposal signed by the president of the Bank and on its strict performance and observance thereafter, bound themselves jointly and severally, in the sum of $20,000, to reimburse the Bank to the extent of $20,000, for any loss sustained through Schardt's act or fraud in connection with his duties as cashier and constituting embezzlement or larceny. The bond was made subject to certain conditions endorsed on it, among which were the following:

1. Any misstatement of a material fact in the declaration within mentioned or in any claim made under this bond, will render this bond void from the beginning.

2. That the said employer shall use all due and customary diligence in the supervision of said employee for the prevention of default, and to that end shall cause an inspection of his accounts to be made at least once within twelve months.

The guarantee proposal contained nineteen questions concerning Schardt and circumstances of supervision, etc.

Of these, only the following are material:

Q. 4. Have you known or heard anything unfavorable as to his habits or associations, past or present? Or of any matter concerning him about which you deem it advisable for the Company to make inquiry?

A.—No.

Q. 12. Has there been any default in the Bank by any employee in applicant's position?

A.—No.

Q. 13. When were applicant's books and accounts (including cash, securities, and vouchers, if any), last examined, and by whom?

A.—December 31, 1892, by finance committee of Bank, (were they found correct?) and found correct.

Q. 14. In case of applicant handling cash or securities, how often will the same be examined and compared with the books, accounts, and vouchers, and by whom?

A.—Not less than quarterly, and often monthly, by finance committee.

The above answers and representations are true to the best of my knowledge and belief.

This was signed by the president of the Bank. While Schardt was teller he kept the general ledger and the cash book and made the daily statement of the Bank. A clerk kept the individual ledger. The individual ledger was correctly kept. Whenever Schardt abstracted money from the deposits, he would place the items correctly in the cash book, but he would make false totals less by the amount he had taken than the true total, and these false totals he would transfer to the individual deposit account on the general ledger. Until 1890 it had been the practice in the Bank every month to take trial balances of the individual ledger accounts and verify the balances thus shown with those of the general ledger. Schardt directed the clerk to discontinue this, and thereafter, from 1890 until the collapse of the Bank, no balance was ever taken from the individual ledger, and no comparison was ever made between Schardt's balances as shown by the general ledger, and those which could have been shown by the individual ledger.

These two ledgers were out of balance $2,098 January 16, 1891; $19,600 January 1, 1892, and $69,700 January 1, 1893. The discrepancies were caused by Schardt's embezzlement of the deposits. In addition to this amount, Schardt embezzled $3,765.44 in the year between January, 1891, and January, 1892, and $4,015.44 in the year between January 1, 1892, and January 1, 1893, of money received by him from the proceeds of notes due the Bank and in his custody for collection. The finance committee of the board of directors of the Bank made quarterly examinations of the Bank. These examinations consisted of checking over a statement made by Schardt of the condition of the Bank, with the notes and securities and cash which he produced, and with statements from other banks of credit balances. There is some doubt as to whether the finance committee saw the cash book or what purported to be a copy of a statement taken from it. The evidence of the experts is that the account of bills payable shown on the cash book and ledger is correct, indeed, that every account except the individual deposit account on those books is correct. Neither the finance committee nor the cashier ever asked for a trial balance from the individual ledgers. After January 1, 1893, when Schardt became cashier, he continued his thefts and between that date and April 17, 1893, the date of his death, he stole $22,964.17 more, so that his total stealings amounted to more than $100,000, or double the entire capital of the Bank. It was in evidence that it was the universal banking custom in banks, large and small, to take trial balances from the individual ledgers at least once a month, and often every two weeks, and to compare these balances with those of the general ledger. A trial balance of the individual ledgers might have been taken by a clerk in one or two days.

It is in evidence that information came to the president and directors of the Bank through their cashier that Schardt was a partner in what is called "a bucket shop," an agency for promoting speculation in small amounts upon the fluctuations of stocks, grain, cotton, and other commodities in which speculative gambling is done, and that he himself was speculating. When charged with this Schardt admitted that he had taken an interest in such a part-

nership, but that he had sold out. He called his former partners to confirm his statement in this regard. He also admitted, according to one of the witnesses, at another time, that he had speculated to some extent, but asserted that he had always made gains, and had seen the error of his ways and had stopped. Subsequently the cashier received an anonymous letter stating that Schardt was still speculating. He informed the president of the Bank. Schardt said it was a lie, and no more attention was paid to it. All this occurred prior to the time when the president signed the guarantee proposal for the cashier's bond referred to. As a matter of fact, Schardt was speculating all the time, and lost the $100,000 he had stolen in gambling in futures.

HAMMOND, District Judge, delivered the opinion of the Court.

The first question which arises on this record is one of jurisdiction. Was there a separable controversy between the plaintiff, a citizen of Tennessee, and the Guarantee Company, an alien corporation? The contracts upon which the action was founded were somewhat different in form. In the bond for Schardt as cashier there is no provision by which Schardt assumes an obligation directly to the Bank for his own defalcations. He seems to be made a party merely that he may enter into certain obligations to the Guarantee Company in case of his defalcation. It can hardly be said, therefore, that the Guarantee Company's liability to the Bank is joint with that of Schardt. In the teller's bond, however, the obligation of Schardt and the Guarantee Company is joint and several. In suit upon the latter, therefore, the Bank and its assignee had the option to begin its action against the obligees jointly or separately, and the obligee could not control the form of the action in this regard. Therefore it could not be removed as a separable controversy by the Guarantee Company when Schardt was its codefendant against the objection of the plaintiff. Of course the plaintiff could if it chose at any time dismiss Schardt's representatives from the suit and make it a several suit against the Company. By making no objection to the removal, by making no motion to remand, and by proceeding to trial without protest and taking a separate judgment against the Guarantee Company we must hold that it consented to a severance of the joint action into two

several actions, one against Schardt, which seems to have remained in the State Court or to have been dismissed, and the other against the Guarantee Company, of which the Court below might properly take jurisdiction on the ground of diverse citizenship. Of course consent can not give jurisdiction to the Federal Court over an action not cognizable therein, but when it is cognizable as its form is joint or several, and a party has the option to treat it as either, we think in order to maintain the jurisdiction when it has been exercised, without objection from him, that he should be held to have elected to treat the action as several as of the time when the removal was effected. Where a petition for removal is filed after the time required by law and no objection is made before trial, the defect is waived.

Martin's Adm'r v. *B. & O. R'y Co.*, 149 *U. S.*

By analogy in such a case as this where it is completely within the power of a party to frame or change his action so as to be cognizable in the Federal Court, and by his silence and affirmative conduct avoids any question of the jurisdiction and proceeds to trial, he does thereby elect to change his action to one within the Court's jurisdiction.

The next question is also one not raised by the parties but one to which the Court must refer. This is a bill in equity to recover on a contract of fidelity insurance. Equitable jurisdiction was asserted in the bill on the ground that the determination of the liability of the defendant involved the examination of a complicated account not conveniently to be examined in a Court of law and also on the ground that there were quite a number of credits to be allowed the defendant in the account, the proper mode of applying which required the action of a chancellor. A stipulation filed in the case above shows that both parties preferred the equity jurisdiction and no objection is made to it in this Court. It may be doubtful whether if the point had been sharply contested by demurrer below, the equity of the bill could have been maintained. It is true that there is a concurrent jurisdiction of matters of account in law and equity. 1 Story's Eq. Jurisp. 443. But it is laid down that where all the items of the account are on one side and no discovery is asked, there is no equity jurisdiction. 1 Dan-

iells' Ch. Pr., 551; 1 Story's Eq. sec. 459; *Fowle* v. *Lawrason*, 5 Peters, 495. It is true there are a few large items of credits, but it is not clear that they would make the account a mutual one in the sense in which it is understood in equity. However this may be, we think it our duty to proceed to consider the cause on the merits under the rule laid down by this Court in *Reynolds* v. *Watkins*, 9 C. C. A., 273, and *McConnell* v. *Provident Savings Life Assurance Society*, 69 Fed. Rep., 113. In those cases we held, following the decisions of the Supreme Court, that where a case with no trace in it of a ground for equitable jurisdiction of it came before the appellate court, it was the duty of this Court to reverse the decree and remand the case to the lower Court with instructions to redocket the cause on the law side; but that where the case was of a class of cases usually cognizable in equity but lacking only in some one element necessary to justify that jurisdiction, it was too late for a party who had consented, or not objected, to the forum below, to urge the objection in this Court. We followed in these cases the distinctions shown in the decisions of the Supreme Court of the United States in the following cases: *Reynes* v. *Dumont*, 130 U. S., 355; *Kelbourne* v. *Sunderland*, 130 U. S., 505; *Lewis* v. *Cocks*, 23 Wall., 466; *Oelricks* v. *Spain*, 15 Wall., 211. The feature of the complicated account is certainly present in the case at bar, and thus it is of a class of cases cognizable in equity, and though the fact that the defendant's credit items are not numerous enough to make it strictly a case of mutual accounts, we think it within the rule which requires us to enforce a waiver of the question of equitable jurisdiction against a party objecting for the first time in the appellate court and which *a fortiori* requires us to maintain the jurisdiction when, as in this case, no objection is made even here. See also *Waite* v. *O'Neil*, 72 Fed. Rep., 348.

The defenses to this action involve a proper construction of the language of the bonds rather than any conflict about the facts. While in contracts like this the more natural attitudes of a "surety" is assumed by the form, it is, in effect, one of insurance, and whatever indefiniteness of language or ambiguity of expression there may be should be resolved most favorably to the assured, not only because it is the language of the insurer, but also because the

general purpose of the contract is full indemnity, and this should not be defeated except by clear and unambiguous limitations assented to by the parties. *Imperial Fire Insurance Co.* v. *Coos*, 151 U. S., 452; *Thompson* v. *Phoenix Ins. Co.*, 136 U. S., 287, 297; *National Bank* v. *Ins. Co.*, 95 U. S., 673, 678--'9; *Supreme Council, Catholic Knights of America* v. *Fidelity & Casualty Co.*, 63 Fed. Rep., 48; *Tibbits* v. *Ins. Co.*, 73 Fed. Rep., 95, 96; *American Credit Indemnity Co.* v. *Wood*, *id.*, 81, 88. And the safe-guarding of this rule against any abuse of its application is nowhere better done than by Mr. Justice Jackson when he says: "But the rule is equally well settled that contracts of insurance, like other contracts, are to be construed according to the sense and meaning of the terms which the parties have used, and if they are clear and unambiguous their terms are to be taken and understood in their plain, ordinary, and popular sense."

Imperial Ins. Co. v. *Coos, supra.*

It is a familiar rule of interpretation that we shall look to the general purpose of the parties to the contract to see what they intend to provide. *Waite* v. *O'Neil*, Court of Appeals, Sixth Circuit, October term, 1896. The old-fashioned bond to secure fidelity of trust administration being a contract of suretyship, strictly, and not of indemnifying insurance, in the expansion of the modern contrivance of organizing incorporated companies to furnish a guaranty of fidelity, these contracts naturally took the form of a bond, as these do, rather than that of a policy of insurance. But as to this subject-matter of indemnity, as well as to the multitude of others formerly covered by bonds to which the principle of insurance is being so comprehensively applied, the general object is that of a protection as broad at least as that afforded by the old-fashioned bond, the form of which has been assumed, and for which the modern contrivance is intended to be a substitute. Marine, fire, or life insurance against the destructive forces of nature are not quite the same thing as an insurance against the dangers of dishonesty and the risk being entirely of a different nature, the courts must interpret the contract in view of this difference, applying the words used to the purpose of covering the peculiarities of

the risk assumed on the one hand and on the other intended to be discarded, or shifted to others. And if these new contracts, whatever their form, are to be turned into contracts of insurance, the courts will be careful not to again perplex themselves with regretable technicalities of law, such as have sometimes crept into the older contracts of insurance and have required statutes for their removal. In marine, fire, and life insurance it is not an unreasonable assumption that the owner knows more intimately than others can know the conditions which are material to the risk assumed, and it is therefore not unreasonable to require him to disclose those conditions to the insurer and to hold him strictly to that duty. But in an insurance like this the insurer and the insured deal at arm's length with each other and upon a plane of equal opportunity for information. Indeed, the risk does not depend so much on conditions of fact as upon a mere judgment about human character in the subject of the insurance—his individuality of moral qualities. About this the insurer can inform himself and the assured is not presumed to know anything, as in the case of the owner of a property or a life which has been insured. Hence it is not unreasonable to hold the insurer to his risk in the broadest sense that is required to indemnify the assured for any loss by dishonesty which falls fairly within the employment of the person whose honesty is guaranteed, and to permit no escape except by lines of retreat or avenues of deliverance clearly defined, well marked and mutually understood as part of the contract—evidenced by the use of unambiguous language for that purpose. It would be contrary to public policy to inconsiderately allow the protection afforded by this new insurance to the vast business interests of the country, in public administration, as elsewhere, to be endangered by any lesser indemnity than that of the old form, by bond, which is being so rapidly displaced, the new contracts being offered by the companies as superior to the old in safety. The courts should interpret them with a view of accomplishing what the companies propose to secure by adhering strictly to the rule we have quoted in the language of Mr. Justice Jackson. And we wish further to remark that the business honesty or fidelity insured by such contracts as these is not that kind of enforced honesty which

comes of a want of opportunity to be dishonest, but that which is to be sturdy enough to operate for safety, spite of opportunity and temptation. That is the only kind of insurance worth the premium paid by the assured, or which is a fair consideration for the risk of loss which he opens under the protection of the guaranty, and, in the absence of evidence to the contrary, presumably that which is bargained for in each instance. A kind of honesty which will not take advantage of lapses of watchfulness to construct deceitful appearances adjusted to familiar traits or habits of carelessness on the part of the employer, perhaps indulged because of reliance upon the insurance which has been accepted as a protection. An employer would need no insurance against that close and relentless vigilance which makes stealing impossible, and under these contracts he is bound to no watchfulness except that which he has contracted to use, in plain words, for the benefit of the insurer.

The old form of bond and security was usually without covenants for watchfulness or inspection by the employer, or other obligee, and as that is the highest measure of liability of which the business is capable it is that which the obligee would naturally seek for his protection, always desiring presumably to provide by some such guaranty even against his own negligence and careless business habits. The nature of the risk forbids the idea of any implied or general limitations upon the guaranty against loss by dishonesty, and, in our judgment, these contracts are not to be construed as imposing any by mere inference of an understanding between the parties that the business will be conducted with either ordinary or any degree of diligence or prudence as to watchfulness. The insurer gets what he contracts for in respect of that and nothing more, and he must provide by express stipulation for even ordinary prudence on the part of the assured in taking measures for minimizing or lessening the broad risk we have indicated as that most desirable to the assured, and, therefore, that which is intended to be covered by the words of insurance in these contracts; except so far as the "provisos and conditions hereinafter contained" shall have limited that broad liability. Nothing is to be implied not necessarily indicated by the words used, as might

be in other examples of insurance where the relation of the parties and the character of the risk are different, and where those relations properly breed implications that would import a meaning not admissible when the thing guaranteed is so far disassociated from any duty owing by the assured to the insurer as we find in the subject-matter of insurance here.

Coming now to a critical examination of these contracts we find that one of them provides "that the employer shall observe or cause to be observed all due and customary supervision over the said employee for the prevention of default." The other that "the said employer shall use all due and customary diligence in the supervision of said employee for the prevention of default," etc. Much proof was taken to show what kind of supervision is ordinarily and prudently taken by other banks, and generally in the banking business to prevent default, it being assumed that there was a contract here for that kind of supervision, or at least that which ordinary prudence in any business would require. Certainly these words may mean that, but not necessarily. They may mean less; for example, they may mean that "due and customary supervision" which obtained in this particular bank, not over all employees, but over the teller, not over all its business in every direction, but only over that which he did. It may mean that which was in vogue when the contract was made or that coming subsequently into use as affording a better mode of detection. If that supervision which it was customary for the authorities of this bank to keep over the teller was careless and ineffective for detection, it would be none the less "due and customary" and that which they took "to prevent default." The point is argued here as if this were a contract for effective supervision; indeed, as if it were a sort of guaranty by the assured that the insurer would not suffer loss because he would take care of him by that kind of effective supervision which would be sure to prevent it, thus reversing the real relation of the parties. And we are told in the proof and in the argument how readily the default could have been detected if other supervision had been given than that which was made. After the fact we can see how easily these frauds could have been prevented if those who were the victims had suspected Schardt and had watched him and

his books instead of relying on his honesty and these policies guaranteeing it.

But all this is beside the question, which is, whether the words of the contract required any other supervision than such as was given. The words of either of the bonds we have quoted are ambiguous and may embrace any degree or acts of supervision from the highest and most certainly effective to those which are least so, as long as they were "customary" or "due." The standard of excellence or efficiency is not definitely mentioned, nor is any rule of custom definitely prescribed whether of this Bank or of all banks, or of any business in which cashiers and tellers are employed. By the rule we have laid down the defendant Company should have been more specific in defining the supervision they required, and the contract should have added, if that was the intention, all due and customary supervision in use in the best-managed banks or generally in use by banks conducted with ordinary prudence and skill, or some words sufficiently designating the general custom now sought to be relied on—if there were at that time any such general custom prevailing in the management of banks; not words applicable to any prudent supervision in many differing ways, but those pointing out a custom of supervision in the particular way now insisted upon. We might rest the point here, but there are facts in the case which indicate quite satisfactorily what was meant by these words.

The defendant Company in its preliminary investigations undertook by examination with written questions and answers to inform itself of the "custom" of this Bank in regard to frequency of inspections, and it was fully informed by the answers of that "custom." It is, in our opinion, in accordance with familiar, general rules of technical interpretation to read these words by the light of that fact and to hold that this was the "due and customary" diligence in supervision referred to in these bonds and provided for by the contracts; and by the particular rule we have already announced, if any more diligent or other customary supervision was embraced it should have been specified by apt words showing that intention. Courts may acquaint themselves with the persons and circumstances that are the subjects of the written agreement and

place themselves in the situation of the parties who made the contract, view the circumstances as they viewed them, "so as to judge of the meaning of the words and of the correct application of the language to the thing described." *Goddard* v. *Foster,* 17 Wall., 123, 143. Here on the face of this policy the parties were making these particular inquiries and answers a part of the contract, and presumptively they were referring to these particulars in the phraseology to which naturally they might be applied. "When we have satisfied ourselves," says Mr. Justice Miller, "that the policy is susceptible of a reasonable construction on its face, without the necessity of resorting to extrinsic aid, we have at the same time established that usage or custom can not be resorted to for that purpose."

Again, "An express contract of the parties is always admissible to supersede, or vary, or control a usage or custom, for the latter may always be waived at the will of the parties. But a written and express contract can not be controlled or varied or contradicted by a usage or custom, for that would not only be to admit parol evidence to control, vary, or contradict written contracts, but it would be to allow mere presumptions and implications, properly arising in the absence of positive expressions of intentions, to control, vary or contradict the most formal and deliberate written declarations of the parties." *Insurance Co.* v. *Wright,* 1 Wall., 456, 470. Here as there, the argument made goes upon the assumption that all that was indicated by these questions and answers, and which fixes, ascertains, or suggests the kind of supervision in contemplation, is nugatory, and that the whole field is open and the power placed in the hands of one of the parties to dictate the extent of supervision by some other custom, more efficient to have prevented this loss. We think this can not be done.

Precisely the same consideration disposes of the alleged misrepresentation founded on the use of the words "examined" and "verified," as contained in the certificate made previously to the renewal of the teller's bond that his books and accounts as teller had been "examined and found correct," and upon like words as stated in the proposal or statement made on application for the cashier's bond when Schardt was promoted to that employment.

As before, the argument proceeds upon the same assumption that an ordinary, prudent, and careful examination would have developed the stealings that Schardt had covered up. This may or may not be so, for we know that such defaulters are very expert in covering up by false entries and appearances, and often none but the most expert examinations and examiners discover the frauds, and we must, in looking at these certificates, take the appearances as then existing, and not as now uncovered after the discovery by such experts. The defendant Company was competent to pursue such an investigation. It had a manager or agent at Nashville for the purpose of keeping up and procuring information, and was yet contented to rely for reasons we will presently suggest upon these vague and indefinite representations as to that which was done. Now that it appears that the accounts concealed a fraud which close scrutiny behind their face would have developed, we are asked to imply that these words were used to represent that such a close scrutiny had been made in fact, which representation it is argued must have been false, because the frauds were not discovered. This is substantially construing the contract as a guaranty to the defendant Company against the Bank's carelessness in making the examinations or that of its agents. However careless the examination may have been, if made in good faith and the examiners believed the accounts correct, they might truthfully so represent them, albeit they were not correct. The position of the defendant Company leaves no margin here, and holds the Bank to absolute truthfulness, not of the fact of examination made in good faith and a belief in correctness, but of the soundness of Schardt's entries and accounts and their freedom from fraud, no matter how skillfully a fraud may have been concealed by him. The facts do not show any such intentional representation, and the words do not define such a complete assurance. The words "correct" and "verified" may mean that but also less in any degree. One "verifies" an account by merely adding up or doing the other work of mathematical calculation, and finding the figures correct, or by such comparison of entries and items as one may make and find "correct," and any extent of this is "examination," however superficial. These representations do not say that the examination was

skillful or extensive or by comparison of books and trial balances, but only that such examination as was made disclosed no error or fraud, and if this was done in good faith, as there is no doubt it was, it fully meets the representations made unless we are to imply that the parties intended such a thorough examination as would save the insurer harmless, and this, we think, was not contracted for in plain and unambiguous language, as it might have been, if intended. As was remarked by the learned judge at the Circuit, "So long as the Bank officers and the committee acted in good faith, such examination as the appointed committee thought proper and sufficient for the protection of the Bank and its stockholders would satisfy the requirements of this contract as made," and we may add, would be truthfully within these representations. And "if anything more was wanted, it was a matter for specific agreement."

It is to be observed that the inquiries made by the defendant Company did not explore the book-keeping processes of the Bank, nor inquire as to the method employed in the Bank, and yet the defendant urges persistently that any departure from the method in use and any carelessness in book-keeping whereby Schardt was enabled to conceal his frauds is conclusive evidence that the examination and supervision stipulated for was not that which was due and customary, which is to say again that with proper supervision stealing is impossible, and which must come at last to mean that the defendant Company did not, in fact, assure anything. It is also said that Schardt, as part of his scheme to defraud, had ordered certain trial balances to be discontinued, and that they were not taken as they ought to have been, and that by a comparison of different books and original entries and trial balances, the frauds were afterwards and might have been before discerned. It is a sufficient answer to all this to say that these contracts did not specifically bind the bank to this efficient book-keeping, and that it is the common plan of these defaulters to adjust the book-keeping to the service of their concealment — it is the kind of fraud insured against. Schardt had authority or usurped it, to order this discontinuance of trial balances, and it was as much a method of his stealing as the false entries or the putting of the money in his

pocket, and in itself was an act of spoliation like the rest. If it had been the policy of the bank to rely on this vigilance as its sole protection, it would need no bonds or insurance; and if it had been the policy of the insuring Company to protect itself by that eternal vigilance in book-keeping which is the price of safety, it could easily have stipulated for it as a condition of its insurance; not by drag-net generalities to catch any misprisions, but by determinate regulation. It did not do this. And there is a reason for it. If these new companies engaging in this new line of insurance should insist on perfect protection against loss, and demand a stringent, efficient, and unceasing vigilance that would make these frauds next to impossible, they could do no business, and there is no reason why they should exist, or why any one should pay premiums for such limited risks. Business would prefer the old style of bonds, which ask no questions and give a broader indemnity. Hence, these solicitors for the new insurance use these vague, indefinite, ambiguous, and — tested by the implications now demanded — misleading words and phrases that customers may not be deterred by too much visible limitation on the risk; and thus they become what Mr. Circuit Judge Lacombe, in one of the cases we have cited, quoting from the books, calls "a snare for the unwary." The law does not tolerate the spreading of the net nor help it to enmesh its victims.

If we were to concede that the officials of this Bank could not have failed by ordinary prudence to have discovered these frauds, or that without some negligence the losses could have occurred, it would not follow from this that this Company, which has guaranteed to the Bank and its stockholders the fidelity of the teller and cashier, can escape its liability because of such negligence. It has not limited its risk to one arising only when the bank officials act without negligence. If it wishes to do that, it should use apt words in its policy, and say so in plain and unambiguous terms, and then its customers would know that they were paying for insurances against losses that could not occur, for "due and customary" diligence in the sense of the argument we are considering means that kind which always brings discovery the moment the stealing begins. We hold that the proof shows, in respect of this,

that all was done which the contract stipulated should be done, and possibly more, since the policy only stipulated for "an inspection or audit" to be made "at least once in twelve months," and those stipulated to be customary in this Bank were made quarterly, as the insurer was informed; possibly the one enlarges the other, but that point is immaterial, since the greater number of inspections includes the less, and either is thus satisfied.

A separate defense is made on the teller's bond, that it limits the risk to a loss sustained "and discovered during the continuance of the currency of this bond and within six months from the employee ceasing to be in the said service." By manifest misprision of counsel, there is here a misquotation by the insertion of the words "of the currency" after "continuance." Whatever the force of this misprision may be, as the bond is written, it plainly covers any discovery within the next ensuing six months after Schardt had ceased to be teller, provided, of course, the default occurred while the bond was current. The liability on the bond would cover only such thefts as occurred while he was teller under the bond, and when he quit *that* employment, the "said service" would cease. No other service can be meant or applicable to the contract except a service as teller under the bond. If the twelve months of the bond expire and the teller continue in the employment of teller, without a renewal of the bond from this Company, yet, in contemplation of this contract "said service" has ceased, for it means that service which has been insured by this bond and its renewals, and no other service, either as teller or otherwise. That ceases whenever the bond ceases. This relieves the absurdities suggested in the argument based on the misquotation of the bond and a misconception that the discovery must be made while the bond is current; and also prevents the suggested prolongation of the limitation as to time. Whether, if the teller should leave the position of teller so early during the twelve months' duration of the bond that the six months allowed for discovery would expire before the bond itself expired, the time for discovery would, nevertheless by the terms of the bond, continue to the end of the bond, we need not decide. But if he leave so late that the six months' limitation would continue beyond the duration of the bond, we

have not the least doubt that a discovery made within six months from his actual quitting would be within the limitation.

Schardt was elected cashier January 1, 1893. The teller's bond expired January 16, 1893, and the discovery was made in April, 1893. Whether we count the six months from January 1st, or January 16th, seems immaterial, on any facts we know, for either would be within the limitation by a discovery in April next ensuing. If, after his election as cashier, he continued to act as teller, and fraudulently appropriated any money before January 16th, the defendant Company would still be liable, but not for any default as teller after that date. The discovery must have been made within six months from the date, at the very latest, whether he had then quitted the service of teller in fact or not. He had then quitted the service which had been insured, and the bond should read as if it had been written "within six months from the employee's ceasing to be in said service under this bond or its renewals."

Perhaps we should notice that the insuring terms of the bond immediately preceding the above-quoted clause cover defaults "in connection with the duties of said office or position or with any other duties assigned to him by the employer in the said service;" but obviously this does not affect the ruling we have made. It does not enlarge the import of the words "said service" in the limitation clause, as we have construed it. Whether he acts as "teller," strictly so called, or is assigned to "other duties," no matter what, they being all covered by the bond are within the service under the bond, and any acts of any character constitute "said service," but in either clause, as used, these words do not mean the general service as employee at any and all times whatever, but only that general service as an employee of the bank in any kind of duty assigned to the "teller and collector," *during the twelve months covered by the bond* — that twelve months of service being the "said service" meant in either of these stipulations. It might be difficult, under the terms of the bond, to start the running of the six months by any "ceasing of said service," while the employee remained at work in the bank in any capacity, because of the very broad insurance of all duties assigned to him; and pos-

sibly all that the defendant Company can certainly claim under the words the Company itself has chosen to define the limitation for its protection, as applied to the facts of this case, and to them we confine our judgment, is that the six months shall commence not later than the expiration of the bond, and they shall be bound for no discoveries after six months from that date. Again, it is obvious that, under the rules of interpretation we have been applying in this case, that it was the duty of the insured, by plain and unambiguous words, to have fixed any other limitation it intended than this which is most favorable to the assured on the words that are used, and most consistent with the general purpose both parties had in view, namely, to protect twelve months of the service of Schardt in this Bank, giving a reasonable time for terminating that liability by a limitation fixed by the contract, and not depending on the ordinary statute of limitations based on public policy, and measuring that limitation of time from the discovery of the frauds, and not from the date of their commission and concealment of the fact. On the one hand, it might be unreasonable to so construe the words "ceasing to be in said service," as to include a service after the bond had expired, thereby prolonging the limitation on discovery indefinitely in its relation to the termination of the twelve months covered by the bond; and on the other, to so construe the words, "discovered during the continuance of this bond and within six months from ceasing to be in said service," as including only a discovery within the twelve months, thereby cutting off any possible liability for a fraud committed within the last minute of the duration of the bond, or so late as to furnish no time for investigation; but it is an entirely reasonable construction which, consistently with the words, avoids either of these extremes, and fairly requires the assured at the very latest to find the frauds within six months from the termination of the bond. Counsel for the plaintiff denounce these perplexing stipulations as designed to mislead, and they are clearly not definite, open, and unequivocal, as they should be, to express a distinct purpose; but we may point to the fact that our construction is analogous to similar provisions in the ordinary contracts of insurance, and conforms to similar stipulations of this very contract, giving three months for discovery

after cancellation, and to one of the cashier's bond terminating the liability within three calendar months from "the expiring of this bond."

The next defense to be considered is that relating to the "bucket shop speculations" of Schardt, as it is designated in argument. It applies to both bonds, but in a somewhat different form. The language of the condition in the teller's bond is that of a stipulation to notify the insurer of such conduct, and that of the cashier's bond is a representation, or, rather, the defense is that of the misrepresentation of a fact.

It is somewhat difficult, without displaying all the proof with a commentary on the credibility of the witnesses and their opportunities of knowledge, to exhibit the fullest justification of our impression that this defense rests on circumstances comparatively inconsequential, which have become formidable only because of the subsequent developments of Schardt's vast gambling in exchanges called futures, the knowledge of which he concealed from all who were interested, including the agent of the defendant Company, who was one of the community where these transactions took place, and who was there to watch the "habits and associations" of customers of defendant Company, like Schardt, but we can not take the space here to do this, and, therefore, forego it. There is no proof that Schardt ever confessed to speculation or gambling, except that of Sykes, who is somewhat discredited because he has a litigation with the Bank, and an apparent animosity toward it. He is also quite indefinite as to time and circumstances, and does not impress us with the certainty of his recollection, although he uses the language of positive statement. He may confuse what Schardt did admit with what he thus testifies as to his admissions. All the witnesses were speaking about long past circumstances which evidently did not make a serious impression commensurate with that importance which these circumstances now assume in the light of Schardt's defalcations. Sykes recommended him to be cashier in succession to himself and asked for renewals of his bond and evidently, if he be an honest man, these admissions and circumstances did not affect his own belief in Schardt's freedom from serious objection in this employment.

There is not the least evidence of any bad faith on the part of any of these officers of the Bank, including Sykes, the old cashier, in not making a disclosure of what was known, but only of bad judgment in not being more considerably affected by their information.

It may be conceded that it was negligence on the part of the officials of this Bank when they first heard of what they did hear and knew what they did know, not to investigate Schardt's books and accounts with the most rigid scrutiny; and not to have immediately discharged him, unless such an investigation should justify his retention, may have made them and the Bank liable to those of their customers who suffered by him; and that to be a broker for those who speculate and gamble even in so small a way as Schardt confessed that he was a broker, or to be a partner of such a broker, or to be interested in a "bucket shop" if we please, in any way as a broker or customer, is for all bank employees a discrediting "habit and association." We agree to all that is said about this in the cases cited, *Preston* v. *Prather*, 137 U. S., 604; *Prather* v. *Kearn*, 29 Fed. Rep., 498; *Scott* v. *Chester Valley Nat. Bank*, 72 Pa., 479. But this defendant company had not contracted for such a guaranty against negligence as had the depositors and bailees who sustained an action of damages in those cases, and this suggested analogy is neither a legal nor a fair test of the contract duty of the Bank to its insurer against Schardt's dishonesty in the premises. Here again it must be strictly limited to the words it has used in defining that duty, and none is owed beyond the words by any kind of implications energized by any indignation at the negligence of the Bank in not protecting itself, or indignation at the immoral conduct of Schardt. This insurer was insuring the Bank for its protection in just such emergencies and against just such negligence, unless the words of this policy speak to the contrary, and had received the consideration for it, while the depositors of the Bank, in the cases cited, had contracted for either common prudence, ordinary vigilance, or against gross negligence. It is a reversion of the attitude we have here, and it is a perversion of that principle to apply it here.

If Sykes ever told Baxter, the president, that Schardt had admitted in 1892 that he had been speculating in a small way but

had stopped it, as the learned judge at the circuit remarks, that was "a past event;" and as by the same story he had stopped it, the president may have thought it in itself unimportant and dismissed it as the cashier, Sykes, himself did. It may have been gross negligence to the depositors of the Bank to so treat the information; but as he was not then "engaged in speculation or gambling" (according to the information, but not according to the stupendous fact as we now know it), or was not then "indulging in any disreputable habits or pursuits"—if these words apply to "gambling" habits that before were so fully provided for by the stipulation, which may be doubtful—there was no obligation under the stipulation of the teller's bond to report it to defendant Company, whatever may be thought of the obligation to protect the Bank in the future by investigating Schardt and discharging him as a duty to depositors, who otherwise might sue for negligence. If that which was told was as Eatherly states it, that Schardt had put $200 in the bucket shop as one of the partners or stockholders, that was not "speculation or gambling" or engaging in it, in a strict construction such as we must make here, but only being the agent of those who were speculating and gambling; it may be considered a "disreputable" habit or pursuit, but however regarded, and whether it be broadly and liberally interpreted as "gambling" or not, it was, too, "a past event" when the Bank became "aware" of it and the habit had been abandoned—again, according to the information, but not the fact, unfortunately for all concerned.

If, also, that which Sykes tells, was told to Baxter, the president, it is to be now considered in its relation to the representation made preliminary to the cashier's bond. We have an impression that Sykes is mistaken and confuses or enlarges what was known and done after the anonymous letter, but take it as he tells it, and it does not appear that Baxter in bad faith withheld the information. He was answering "to the best of his knowledge and belief," and the warranty is not absolute with such a limitation and can not be, necessarily. If in good faith he did not believe what he heard to be "unfavorable" because Schardt had ceased to deal in the "bucket-shop," or in like good faith did not "deem it advisable" that the insuring company should make inquiry, surely his

answer was true, because he is made the judge of what is "unfavorable" or what was "advisable," at least within the limits of what reasonable men might think about it. Moreover, it is to be observed that unlike that which appears in the teller's bond, which we have just considered, no mention is made of "gambling" or "speculation" in this question. It is "habits or associations," past or present, that are called to mind, and we doubt if "dealing in futures" had come to be considered "gambling" in that "plain, ordinary, and popular sense" of which Mr. Justice Jackson has spoken in the quotation we have made; so as to bring it within the common thought expressed in "habits and associations," as gambling at cards, for instance, surely would be; or if "speculation" had come to be considered "unfavorable." A bank president surely should know that "dealing in futures" was unfavorable, but *non constat* that a single dealing, or small and insignificant dealing which had ceased, was "a habit;" or that it was advisable for the insurer to inquire about it if it had ceased, and he was informed it had. If the information he got was as Fatherly described it, going only to show that Schardt had been a partner in the brokerage agency, then what we have said about the other applies with greater force. Possibly a reasonable man might limit this inquiry to such "habits and associations" and "matters" as the moralists ordinarily condemn as involving turpitude, or as disgraceful and opprobrious, and not include the business sin of wasting one's own money in speculative trading, even in a "bucket shop." If the money be one's own and not fiduciary money, as to which there was no information, it is still ordinarily by those not casuists regarded as more excusable than the common games of chance. At all events, any indefiniteness or uncertainty of language used is to be resolved in favor of the assured and against the insurer, and certainly this "warranty," whatever force it has, leaves the quality of being "unfavorable" or "advisable" to some kind of construction by the mind of him who is answering the question. It is not precisely within the rulings in *Insurance Co.* v. *Gridley*, 100 U. S., 614, nor *National Bank* v. *Ins. Company*, 95 U. S., 673, because it does not depend wholly on the knowledge of the facts, as there, but is a representation as to what has been "heard" by the one an-

swering. Yet, considering the subject-matter, the principle decided is analogous, since the respondent is left to exercise his own judgment about what he has heard, and there is no warranty that that judgment shall be of the best or an absolutely correct judgment, and that is what we are asked to include within the warranty by this defense.

On the authority of *Moulor* v. *Insurance Company*, 111 U. S., 341, and *Insurance Company* v. *Raddin*, 120 U. S., 183, the learned judge at the circuit doubted whether under the strict rule this contract should be taken as a warranty, but did not decide that point, as we do not, since we find that being treated as a warranty, there has been, when properly construed, no breach of it. Baxter, the president of the Bank, had heard what we can now see was unfavorable, and that it would have been advisable for the Company to inquire about it, but under the then circumstances it can not be said that he reasonably should have known that it was unfavorable or advisable to make inquiry, and this was left to his determination by the contract. This was a limitation on the warranty itself and lessened its scope otherwise. We may add to what the learned trial judge said that under the rulings in *Penn. Life Ins. Co.* v. *Mechanics' Bank*, 72 Fed. Rep., 413, the strict rule as to disclosures which have been imported from the marine insurance law and which statutes so often have abrogated as unjust, should not be extended to these new policies, and on this ground all the courts have held that the warranties shall be strictly construed, as we do this.

After the anonymous letter was received and Schardt had been called before the Bank officials, and denying the charge that he had been speculating, had produced witnesses to disprove it, there may have been rumors afloat, as the witnesses testify, perhaps all traceable to that source, but there was no duty on the Bank to run down this kind of information or to report it. It had not assumed the business of a detective agency by the contract. It was held in *American Surety Company* v. *Pauly*, 72 Fed. Rep., 470, 476, under a policy similar to this, but under another clause, which is also found in this, requiring notice in writing of any act which may involve a loss coming to the knowledge of the employer, that

"knowledge" and "suspicion" are not synonymous terms, that the bond does not call for notice of suspicions, but only of a knowledge of some specific fraudulent or dishonest act. The same rule is applicable to the disclosure required under the clause we have in hand so far as it calls for "knowledge" and to the clause in the teller's bond requiring notice on "becoming aware" of speculation and gambling. Mere rumors and suspicions are not included certainly in the teller's bond, and, for the reasons we have indicated, we think not in the other, although it is broader in requiring notice of things "heard" as well as things known. It is not everything heard that is required to be told, but only unfavorable habits and associations or matters important enough for inquiry. We have already stated why these are not included, and the proof shows nothing more formidable than what we considered in that connection. In the case of the *Supreme Council Catholic Knights* v. *Fidelity & Casualty Co.*, before cited, 63 Fed. Rep., 48, 57, the contract could not be affected by loose parol statements or concealment of facts, about which no inquiry was made, or by conduct upon which no reliance was placed, but only by misrepresentation or fraudulent concealment provided against as a part of the agreement. Everywhere this rule is found, that it is open to the insurer to be specific and therefore mere entrapping generalities will not be tolerated.

Objection is made to an item included in the report of the expert bank examiners on which the decree was rendered, of $5,992.35 of "overdrafts allowed and not authorized." It is insisted that this was not embezzlement or larceny. We do not know whether it was or not. It might be, because embezzlement or larceny may be committed through the process of overdrafts. This question was not made by exceptions or passed on in the Circuit Court and was, it is said by counsel, only brought to attention there at the time the decree was entered. It is evidently an afterthought, and there being no proof showing the facts in relation to the overdrafts nor why they were by the examiners included, neither the trial court nor this Court can say they were not embezzlements or larcenies. There is no proof to sustain this objection, which comes too late.

Nei her do we see any objection to the interest allowed. It is urged that it does not appear that the Bank could have made six per cent on the lost money if it had not been stolen, since it did not discover the thefts until 1893, and that the only basis for adding interest is to make good the loss of the use of the money in the meantime. This is a mistaken view of the law of interest. The Tennessee Code allows interest on bonds. Tenn. Code (M. & V. ed.), sec. 2702. If a policy of insurance be not included in this statutory allowance when it takes the form of a bond, as this does, it may be allowed by the jury or the chancellor as "damages" for money detained. Here the defendant Company agreed to make good the loss sustained by the fraudulent acts of the employee, and if Schardt had been sued the jury or chancellor could have allowed interest against him as part of the damages or "loss" and this the defendant Company assured. Interest should be allowed from the date of embezzlements, or from the end of each year, if the jury or the chancellor choose, as he did here, to the filing of the proof of loss, up to the penalty of the bond but not beyond it, of course. Then on this amount there could be no interest for three months, since that sum is not due by the terms of the contract until three months after filing proof of loss. But if not then paid it bears interest as a debt due from that date, if allowed by the jury or chancellor, when not given by statute. We think it should be allowed in this case, whether given by statute or not. Being allowed, it should be calculated to the date of the decree, as in other cases. It will be so allowed here.

On the whole, we are satisfied with the decree of the Circuit Court and with the reasons given for it as found in the record and reported *sub nomine, Mechanics' Savings Bank* v. *Guarantee Company*, 68 Fed. Rep., 459, and it will be affirmed.

APR 28 1900
JAMES H. McKENNEY,
Clerk.

No. 792

Filed April 28, 1900.

United States Circuit Court of Appeals.

SIXTH CIRCUIT.

THE GUARANTEE COMPANY OF NORTH AMERICA,

vs.

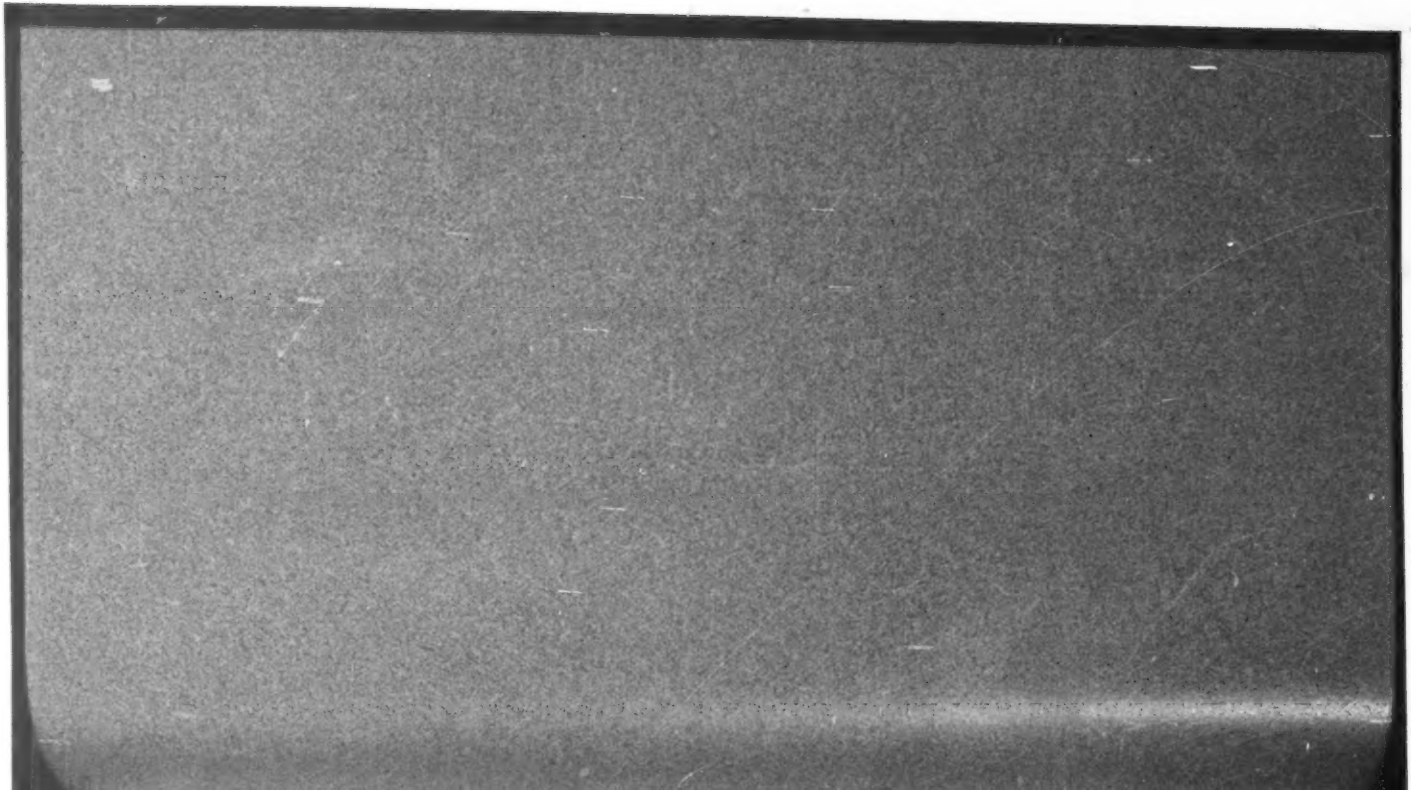
MECHANICS' SAVING BANK & TRUST COMPANY, FOR USE OF JAS. J. PRYOR, ASSIGNEE, ETC.

APPEAL IN ERROR.

BRIEF OF WILLIAM L. GRANBERY,
SOLICITOR FOR APPELLANT.

1900.

GRANDON PRINTING CO.



United States Circuit Court of Appeals.

SIXTH CIRCUIT.

GUARANTEE COMPANY OF NORTH AMERICA,
PLAINTIFF IN ERROR.

VS.

MECHANICS' SAVINGS BANK & TRUST CO., FOR USE, ETC.
DEFENDANT IN ERROR.

STATEMENT.

May it Please Your Honors:

This appeal involves the liability of a Surety Company under two bonds of suretyship issued to a bank to protect it against pecuniary loss resulting from the dishonesty of its teller and cashier.

The litigation originated in a State Court by bill in equity by the Mechanics' Savings Bank and Trust Company, for the use of J. J. Pryor, Assignee, seeking to have an account stated between it and its former teller and cashier, John Schardt, to adjust certain equities between these parties, and to recover upon two bonds of suretyship issued by the Guarantee Company of North America to the Bank, upon Schardt, first as teller, and later as cashier of the Bank.

The case was seasonably removed to the United States Circuit Court at Nashville, Tennessee; and upon a hearing, a decree was rendered against the Company under each bond.[1] Upon appeal to this Court, the decree of the Circuit Court was affirmed.[2] The case was then taken by certiorari to the Supreme Court, where the

[1] 68 Fed. Rep., 459.
[2] 47 U. S. App., 91.

decree of this Court was reversed, because the decree of the Circuit Court was not a final one.[1]

After the cause was remanded to the Circuit Court, a final decree was rendered against the Company, and the case is again before this Court upon appeal.

The material controversy is that involving the liability of the Guarantee Company to the Bank under its two bonds of suretyship.

The Mechanics' Savings Bank and Trust Company, hereinafter called the "Bank," was a banking institution located at Nashville, Tennessee, with a capital stock of $50,000.[2] John Schardt was its teller from 1888 to January 1, 1893, when he was elected cashier, and remained such until his death, on April 17th, following. As teller and cashier he embezzled more than $100,000 of the funds of the Bank, beginning in 1890, and continuing until about the time of his death. About the time that Schardt died, the Bank, ascertaining its insolvency, closed its doors and made a general assignment for the benefit of its creditors.[3]

The Guarantee Company of North America, hereinafter called the "Company," is a corporation organized under the laws of the Dominion of Canada, for the purpose of guaranteeing pecuniary losses occasioned by the fraudulent acts of persons in positions of trust, and has been so engaged in Canada and the United States since 1872. In 1888 it issued to the Bank a bond, for a period of one year, on Schardt as teller, for $10,000, which was subsequently renewed each year until January, 1893, when it issued a bond on Schardt as cashier for $20,000. Generally speaking, each bond insured the Bank, under certain limitations and conditions, against pecuniary loss by reason of the fraudulent acts of Schardt in the respective offices held by him.

This defalcation of more than $100,000 was entirely lost in speculation,[4] and at the death of Schardt he had practically no property, but about $80,000 of life insurance, all of which he

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[1] 173 U. S., 587.
[2] Dep. Eatherly, q. 11, Trans., p. 51.
[3] Bill, Trans., pp. 1–5.
[4] Dep. Eatherly, q. 29. Trans., 53.

assigned to the Bank just prior to his death, to secure his defalcation.

From these collaterals the Bank has realized the sum of $46,838.46,[1] and for the remainder the Company was held liable to the extent of the amount of each bond.[2]

PROVISIONS IN EACH BOND.

In re Teller's Bond.

This bond states:

> "The following provisions are also to be observed, and binding, as part of this bond:
>
> [1] "That the employer shall at once notify the Company, on his becoming aware of the said employe (Schardt) being engaged in speculation or gambling, or indulging in any disreputable or unlawful habits or pursuits."
>
> [2] "That the employer shall observe, or cause to be observed, all due and customary supervision over the said employe for the prevention of default."
>
> [3] "That there shall be an inspection or audit of the accounts and books of the employe on behalf of the employer at least once in every twelve months from the date of this bond.[3]

The original issue of this bond expired in January, 1889, and thereafter in January of each succeeding year. Before the bond was renewed each year the Company furnished the Bank with a blank form to be filled out, which provided as follows:

> "It is necessary, before the bond can be renewed, that you obtain the certificate hereon of your president or cashier, and on its return, with remittance of the premium, the renewal can be immediately effected."

The Bank executed and delivered the required certificate at the end of each year, and paid the premium of $100, which

[1] Trans., p. 119.
[2] Trans., p. 119.
[3] Trans., p. 13.

effected a renewal for the succeeding year. The certificate was filled in and signed by the cashier of the Bank, and among other things it stated that the accounts of said teller, Schardt, "had been examined and *verified* by the finance committee of the Bank"; and the bond was not renewed any year until this certificate had been made out and delivered to the Company.[1] The last renewal of this bond was in January, 1892.

In re Cashier's Bond.

In January, 1893, when the teller, Schardt, was elected cashier of the Bank, an application was made to the Company for a bond of $20,000, and before agreeing to issue it the Company required of the Bank answers to certain questions, which were addressed to Lewis T. Baxter, president, and distinguished as "Employer's Guarantee Proposal." In asking the questions it was stated: "In order that the directors of the Company may be fully informed in deciding upon the proposal, it is desired that the answers be as full and definite as possible, for mutual protection." Among other questions, all of which were answered by the president of the Bank on its behalf, were the following:

> "*Q.* 2. If a *new* employe, by whom was the applicant introduced, or how did he become known to you? If hitherto in continuous service, for how long, in what capacities, and has he uniformly performed his *duties* faithfully and satisfactorily?
>
> *A.* Applicant began service in this bank six years ago as collector clerk, and has since been advanced to Bank's teller, and now cashier.
>
> *Q.* 3. Has he ever been in arrears or default in the Bank's service, or, as far as you have heard, in any previous employment?
>
> *A.* No.
>
> *Q.* 4. Have you known or heard anything unfavorable as to his (Schardt's) habits or associations, past or present? No. Or of any matters

[1] Stipulation, Trans., p. 106.

concerning him, about which you deem it advisable for the Company to make inquiry? No.

Q. 9. Amount of bond hereby required, from what date to commence, and by whom premium will be paid?

A. Twenty thousand dollars, to date from January 1, 1893, premium payable by Bank.

Q. 10. What further security, if any, will be held or required from applicant?

A. None.

Q. 13. When were applicant's books and *accounts* (including cash, securities, and vouchers, if any), last examined, and by whom?

A. December 31, 1892, by finance committee of Bank (were they correct?) and found correct.

The above answers and representations are true to the best of my knowledge and belief."[1]

The cashier's bond was thereupon executed and delivered to the Bank, and among other things provided:

"Now, therefore, this bond witnesseth, that the said employe, for and on his own behalf, and the said Company, fully relying on the truth of the statement and declaration contained in a certain document, distinguished as Employer's Guarantee Proposal No. 154,806, dated the 10th day of January, 1893, and signed 'Lewis T. Baxter, President,' on behalf of the said employer, and lodged with the said Company at its office in Montreal, . . . do hereby . . . covenant with the said employer to reimburse unto the said employer, etc."

"This bond is granted upon the following express conditions:

"1. Any misstatement of a material fact in the declaration within named, or in any claim made un-

[1] Stipulation, Trans., p. 109.

der this bond, will render this bond void from the beginning.

3. That any written answers or statements made by or on behalf of said employer in regard to or in connection with the conduct, duties, actions, or methods of supervision of the said employe, delivered to the Company either prior to the issue of this bond, or to any renewal thereof, or at any time during its currency, shall be held to be a warranty thereof, and form a basis of this guarantee, or of its continuance."[1]

SPECULATION.

Schardt was a heavy speculator. Within less than two years his losses amounted to over $100,000. So imbued was he with the fever of speculation that he became part owner of a "bucket shop," or brokerage concern. In the summer of 1892, during the time the last renewal of the teller's bond was in force, and before the issuance of the cashier's bond, Sykes, the then cashier of the Bank, was informed of the conduct of the teller in this regard, and at once notified Baxter, the president of the Bank. Schardt was questioned on the next day, and admitted that at one time he had been interested in such concern, but had sold out his interest. He also admitted that he had been speculating to some extent, but had ceased to do so. Substantially the same things were stated by Schardt to Eatherly, a director and member of the finance committee of the Bank. Some time thereafter, and prior to January 1, 1893, when the cashier's bond was issued, Sykes, cashier, received an anonymous letter again informing him that Schardt was speculating. This was also laid before the president of the Bank. Eatherly also received an anonymous letter giving him similar information, which he showed to the president.

The entire testimony upon this question of speculation is here set out in detail:

[1] Trans., p. 10.

Testimony of Charles Sykes.[1]

Q. 5. Were you cashier of the Bank during the whole of the year 1892?

A. Yes, sir.

Q. 6. Did you, at any time during that year, receive information that John Schardt was speculating? If so, state when, how, and all the circumstances.

A. Yes, sir; I did receive such information. Some time in the summer or fall of 1892 a gentleman by the name of Kyle came here from New York, representing Myers & Co., of New York. Kyle wanted me to become interested in the brokerage business and represent Myers & Co. at this point. I told him that I did not like the idea, because it would be purely a speculative business, and he then said that made no difference, that John Schardt, our teller, was a partner in a similar concern.

Q. 7. Did you impart this knowledge to any one? If so, whom?

A. Yes, sir; I at once told Mr. L. T. Baxter, the pesident of the Bank, of the conversation.

Q. 8. Did you say anything to Schardt about the matter?

A. Yes, sir; on the next day, I think, I told Mr. Schardt of what Mr. Kyle had said.

Q. 9. What did Schardt say to you in reply?

A. He admitted that he had at one time been interested in such a concern, but had sold his interest; and that he had speculated to some extent, but had made money on every transaction, and had seen the error of his way, and had ceased to do so any more.

[1] Trans., p. 77.

Q. 10. Did you impart this information received from Schardt to anyone connected with the Bank? If so, whom?

A. Yes, sir; I immediately told Mr. Baxter, the president of the Bank, what Schardt had said.

Q. 11. Did you receive any other information at any other time, with reference to Schardt speculating?

A. Yes, sir; some time thereafter I received an anonymous letter, telling me that Schardt had been speculating.

Q. 12. What did you do with it, and what became of it?

A. I showed it to Mr. L. T. Baxter, the president, and he said not to pay any attention to an anonymous letter; and I spoke to Schardt about it, and he said he thought he knew the author, and asked me to let him have the letter and he would bring the party before me and make him acknowledge it was false.

Q. 13. Did you give him the letter, and did he bring the party before you?

A. I gave him the letter, and asked him about it more than once, and he always replied that he was working on it.

Q. 14. Did you tell Mr. Baxter of this conversation?

A. I think I did.

Testimony of J. M. Eatherly.[1]

DIRECT EXAMINATION.

Q. 2. State what have been your relations with the Mechanics' Savings Bank and Trust Company for several years past.

[1] Trans., p. 50.

A. I was a director in the Bank from its organization until its assignment.

Q. 3. Did you fill any other position?

A. For a considerable length of time I was on the finance committee, and for about twenty days I was president of the Bank.

Q. 4. Please state what twenty days you were president.

A. I was elected on the 28th of March, 1893, and the Bank assigned on the 17th of April.

Q. 8. During what time were you on the finance committee?

A. I was, for several years, and prior to my election as president.

CROSS-EXAMINATION.[1]

Q. 98. Did you ever hear of Schardt's speculation before January, 1893?

A. I think I did.

Q. 99. Did you see the anonymous letter written with respect to his speculating?

A. I saw a letter directed to Judge John Woodard. Judge Woodard brought that letter to the Bank and showed it to me, and I asked permission to call Mr. Schardt up and show it to him, and he said that he was perfectly willing that I should do so. I at once called Mr. Schardt to where we were, and told him there was a communication I wanted him to read. He did so, and his remarks were: "It's a lie, and I can prove it!" In this letter it was stated that Mr. Schardt was a partner in a bucket shop. I told Mr. Schardt that it devolved on him to prove it false. I at once reported the contents of this letter to the president of the Bank, Mr. Baxter. Mr. Schardt asked that I and Judge Woodard remain

[1] Trans., p. 61.

there for a few minutes. He went out and got Frank Searight and Dr. Barry. Judge Woodard, Mr. Baxter, and myself went into the rear of the Bank building. Mr. Schardt and the other gentlemen came back, and Mr. Schardt says: "Here are the men who can tell you whether that is so or not." I asked them if they knew why we had sent for them, and they said Mr. Schardt had told them. Mr. Searight said that, some time before, Mr. Schardt, Dr. Barry, and himself had agreed to open a brokerage association. They objected very much to the term "bucket shop." Each one was to put in a small amount, $200, I think. Mr. Schardt in a short time became dissatisfied, and sold his interest to Frank Searight at a small loss. Subsequent to that I went to Mr. Schardt's house to see him, having heard again that he was speculating. I told him what I had heard, and he said that it was not so; that he did not own any stocks at all. I told him if he was he ought to quit that or quit the Bank, and he said he had sold everything he had. I again heard that he was speculating, but from sources that I did not attach any importance to, as it all emanated from the same source as the anonymous letter. I again approached him, and he denied it.

Testimony of Theo. Cooley.[1]

Q. 3. Did the defendant Company at any time cancel its bond on John Schardt while he was cashier of the complainant company? If so, when, and for what reason?

A. Yes, sir; the Company did cancel its bond through me, as its agent, the Saturday before the Bank assigned on Monday. The cause which led to this action was that I had ascertained that John

[1] Trans., p. 98.

Schardt had been speculating in futures, and I so reported to the Bank when the bond was canceled.

Q. 9. Did you know or hear of Schardt's speculations prior to the time mentioned above when you received such information?

A. I did not.

Q. 10. Have all matters pertaining to the issuance of the bonds upon Schardt in favor of the complainant passed through your hands as representative of the Company?

A. They have, so far as I know.

Q. 11. Is it or not a part of your duties to gather information concerning applicants for bonds, and about persons already bonded in the defendant Company, in this part of the country?

A. Yes, sir.

Q. 12. Do you transmit such information to the home office of the Company?

A. I do.

Q. 13. If the Company had received any information with respect to Schardt's speculations, or other information unfavorable to him, would you have been advised of the fact by the Company?

A. I would, as that is the usual method of doing business.

All of the above testimony was brought out by counsel for the Company, and not one question, direct or indirect, was asked by counsel for the Bank of any one of these or other witnesses, to either contradict or vary what had been brought out by counsel for the Company upon this question of speculation. Whatever was developed along this line for the Company was allowed to rest without any effort to vary or contradict the same.

No information concerning this speculation was, at any time, furnished the Company or its agent at the place where the Bank was located.

BANK BOOKS.

There was kept in the Bank an individual ledger, which showed in detail the deposit account of each depositor. This book was kept by a clerk who had no other duties, and was known as the "individual bookkeeper." Schardt had nothing to do with the keeping of this book. There were three other books, all kept by Schardt: (1) A general ledger, showing generally the accounts of the Bank, including the total deposits, but not in detail the accounts of depositors. There was kept in this book an account of demand loans, discounts, bonds, stocks, etc. It purported to show the total deposits paid in and those checked out each day, *and purported to show at the end of each day's business the aggregate amount due to depositors.* (2) A daily balance book, which showed a summary of each account in the general ledger. It showed on each page, at the end of each day's business, all the assets and liabilities of the Bank under appropriate heads; it showed the amount of notes, cash, stocks, bonds, etc., owned by the Bank, and the amount the Bank owed *depositors*, other banks, bills payable, etc.[1] (3) A cash book, in which each day's business was grouped on one page, instead of putting the business of each day under the various accounts, as in the general ledger, each page of the cash book showing the entire business transacted that particular day, each page beginning with the cash on hand at the opening of the Bank any particular day would be debited with all the receipts for the day, and showing from what source derived, and would be credited with all disbursements and showing on what account made.[2] These were the principal and only material books kept in the Bank.[3]

The aggregate amount due depositors on the individual ledger, and the general ledger balance, showing the amount due depositors, should at all times have agreed, the individual ledger showing the amount due *each* depositor, and the general ledger the aggregate amount due *all* depositors.[4] These balances were compared

[1] Trans., p. 43.
[2] Trans., pp. 44-5.
[3] Dep. McEwen, cross-q. 4, Trans., p. 35.
[4] Dep. Boench, q. 9, Trans., p. 76.

and made to agree as often as every thirty days, until just before Schardt commenced to abstract money, in the latter part of 1890. After that time no comparisons were ever made,[1] although it is customary in all banks to have them made as often as every thirty days.[2]

The individual and general ledger were out of balance January 16, 1891, $2,098; January 1, 1892, $19,600, and on January 1, 1893, $69,700.[3]

The individual ledger was properly kept, and correctly showed the amount due to each depositor.[4]

The general ledger was not properly kept, and after the latter part of 1890 did not correctly show the amount due to depositors. It was not correct because Schardt, as teller, abstracted the funds of the Bank, and understated on the general ledger the amount due to depositors by the amount he had abstracted to that date. And the difference in the balances represented a shortage by Schardt of that amount at the respective dates.[5]

On April 15, 1893, the Bank employed an accountant to examine Schardt's books.[6] He, by merely comparing the individual and general ledger balances, ascertained and reported the embezzlement to the Bank.[7]

Schardt also abstracted proceeds of notes paid to him as teller. His books were not falsified to conceal this character of shortage, but the amount of notes in the Bank did not equal the amount called for on Schardt's books by the amount he had abstracted. This character of shortage continued for three years prior to the assignment.[8]

On January 1, 1892, when the Bank procured a renewal of the teller's bond by representing to the Company that his books and

[1] Dep. Boench, q. 6, Trans., p. 75.

[2] Dep. Fischer, q. 4, Trans., p. 88; Dep. Duncan, q. 12, Trans., p. 83; Dep. McLaughlin, q. 5, Trans., p. 80; Dep. Harris, cross-q. 4, Trans., p. 74.

[3] Dep. McEwen, cross-q. 43, Trans., p. 42.

[4] Dep. McEwen, cross-q. 42, Trans., p. 42.

[5] Dep. McEwen, cross-q. 24, Trans., p. 39.

[6] Dep. McEwen, cross-q. 1, Trans., p. 35.

[7] Dep. McEwen, cross-q. 5, Trans., p. 36.

[8] Dep. McEwen, cross-q. 37 and 43, Trans, p. 41, 42.

accounts had been examined and *verified*, the bank books kept by Schardt showed that he was a defaulter for $23,169.34; of this shortage $19,600 was abstracted deposits, and $3,765.44 proceeds of notes collected and not accounted for, as shown on the books of the Bank.[1] On January 1, 1893, when Schardt was made cashier, and the bond on him as such was procured to be issued, by the Bank representing to the Company that his books and accounts had been *examined* to that date and found *correct*, his shortage was $78,819.24; of this amount $69,700 was abstracted deposits, and $4,015.44 proceeds of notes collected, all of which was apparent upon the books of the Bank.[2] The capital of the Bank was $50,000.[3]

[1] Dep. McEwen, cross-q. 43, Trans., p. 42.
[2] Dep. McEwen, cross-q. 43, Trans., p. 42.
[3] Dep. Eatherly, q. 11, Trans., p. 51.

ASSIGNMENT OF ERRORS.

TELLER'S BOND.

1. The Bank agreed to immediately notify the Company on becoming aware of the employe being engaged in speculation, and the Bank learned that the employe had not only been speculating, but had been part owner in a gambling concern, and neither investigated the matter on its own account, nor notified the Company.

2. The Bank procured the teller's bond to be renewed in January, 1892, by representing that the employe's books and accounts had been examined and *verified*, when the *books of the Bank showed a default of* $23,365.44, in a bank with a capital of only $50,000.

3. The Bank agreed to "observe, or cause to be observed, all due and customary supervision over the said employe *for the prevention of default*," and during the currency of the bond ceased to compare ledger balances, or correctly count the notes held by the Bank, which was not only customary with other banks, but was customary in this Bank up to the time this shortage commenced.

4. The bond provided that there should be "an inspection or audit of the accounts and books of the employe on behalf of the employer at least once in every twelve months," yet the ledger balances were not compared, and the notes in the Bank were not counted or compared with the amount called for by the books; every page in the books kept by him was incorrect; and no inspection or audit of his books or accounts was made.

CASHIER'S BOND.

1. The Bank represented that it did not know of and had not "heard of anything unfavorable as to the habits or associations, past or present," of the employe upon whom it was seeking the issuance of the bond; yet at the time the Bank, *and the particular officer, making the statement for the Bank, knew* that the employe had been engaged in speculation, and had been a partner in a gam-

bling concern, while occupying a position of trust in the Bank, and no effort was made to verify his statement that he had sold out his interest in the "bucket shop" and had ceased speculating.

2. The Bank procured the issuance of the cashier's bond by representing that the books and *accounts* of the employe, who had been its teller for five years, had been examined and found correct to the end of his term of office; yet at that time the *books of the Bank showed a default* of $73,715.44, in a bank with a capital of only $50,000.

3. The Court allowed $5,992.35 of overdrafts "allowed but not authorized," as a part of the default for which the Company was liable, although the bond only protected the Bank against a default "constituting embezzlement or larceny."

BRIEF AND ARGUMENT.

I.

GENERAL PRINCIPLES.

The Supreme Court has quite recently announced the rules of construction applicable to this form of insurance contracts:

*If, looking at all its provisions, the bond is *fairly* and *reasonably* susceptible of two constructions, one favorable to the Bank and the other favorable to the Surety Company, the former, *if consistent with the objects for which the bond was given,* must be adopted, and this for the reason that the instrument which the Court is invited to interpret was drawn by the attorneys, officers or agents of the Surety Company. This is a well established rule in the law of insurance. *National Bank* v. *Insurance Co.*, *95 U. S., 673; Western Ins. Co.* v. *Cropper, 32 Penn. St., 351, 355; Reynolds* v. *Commerce Fire Ins. Co., 47 N. Y. 597, 604; Travelers' Ins. Co.* v. *McConkey, 127 U. S., 661, 666; Manchester, etc., Life Ass'n, 3 B. & S., 917, 925.* As said by Lord St. Leonards in *Anderson* v. *Fitzgerald, 4 H. L. Cas., *483, *507,* "it [a life policy] is of course prepared by the company, and if therefore there should be any ambiguity in it, must be taken, according to law, most strongly against the person who prepared it." There is no sound reason why this rule should not be applied in the present case. The object of the bond in suit was to indemnify or insure the Bank against loss arising from any act of fraud or dishonesty on the part of O'Brien in connection with his duties as cashier, or with the duties to which in the employer's service he might be subsequently appointed. That object should not be defeated by any narrow interpretation of its provisions, nor by adopting a construction favorable to the Company *if* there be another construction *equally* admissible under the terms of the instrument executed for the protection of the Bank.

American Surety Co. v. Pauly, 170 U. S., 133.

In *Travelers' Insurance Co.* v. *McConkey* (*ibid*) it is said:

Such being the contract, the Court must give effect to its provisions according to the *fair* meaning of the words used, leaning, however — where the words *do not clearly* indicate the intention of the parties — to that interpretation which is most favorable to the insured.

*Italics added.

To these rules of construction, natural and reasonable as all must admit, no criticism can be made. However, Courts will not speculate upon what particular words and phrases may or might mean, where there is a natural and usual meaning attached to them, easily understood, and not *fairly* and *reasonably* susceptible of two constructions, and *clearly* indicating the intention of the parties.

Whatever conditions are contained in the contract will be upheld and enforced by the Court:

In *Imperial Insurance Co.* v. *County of Coos,* 151 U. S., 452, Mr. Justice Jackson delivering the opinion, says:

> Contracts of insurance are contracts of indemnity upon the terms and conditions specified in the policy or policies embodying the agreement of the parties. For a comparatively small consideration the insurer undertakes to guaranty the insured against loss or damage upon the terms and conditions agreed upon, and upon no other; and when called upon to pay, in case of loss, the insurer, therefore, may justly insist upon the fulfillment of these terms. If the insured can not bring himself within the conditions of the policy he is not entitled to recover for the loss. The terms of the policy constitute the measure of the insurer's liability, and in order to recover, the assured must show himself within those terms; and if it appears that the contract has been terminated by the violation, on the part of the assured, of its conditions, then there can be no right of recovery. The compliance of the assured with the terms of the contract is a condition precedent to the right of recovery. If the assured has violated or failed to perform the conditions of the contract, and such violation or want of performance has not been waived by the insurer, then the assured can not recover. It is immaterial to consider the reasons for the conditions or provisions on which the contract is made to terminate, or any other provision of the policy which has been accepted and agreed upon. It is enough that the parties have made certain terms conditions on which their contract shall continue or terminate. The Courts may not make a contract for the parties. Their function and duty consist simply in enforcing and carrying out the one actually made.

The contract should be read in the light of the purpose for which it was made, and the statements and acts of the parties in the light of the surrounding circumstances.

This Court knows judicially that the most prudent and conservative financial institutions, exercising the strictest supervision, require their employes occupying positions of trust to be bonded against any fraudulent conduct involving a loss to the institution.

No supervision, however careful or thorough, can prevent losses of this character. No system of keeping accounts, or examinations, can eliminate this risk. The most that can be expected is to discover the fraud before the loss becomes serious. Hence it is that only bonds for sufficient amounts to cover this character of risks are required and accepted. The amount of the bond is but a small percentage of what the employe may have access to in the usual course of his employment, but by exercising due and customary supervision, and with a proper system of examinations, the chance of any default becoming serious before discovery is minimized. Experience teaches that honest men rarely become dishonest in a day. Temptation, when first encountered, is easily resisted; with each succeeding encounter the power of resistence is weakened. Defaults are small in the beginning, and gradually increase to enormous amounts, if not sooner detected. Persons of experience and observation have found that persons in positions of trust who speculate in stocks, grain, cotton, provisions, and like commodities, invariably, lured on by the hope of retrieving past losses, become defaulters to large amounts. They have further found that persons in positions of trust who are in the habit of gaming will, sooner or later, become losers, and, in consequence, defaulters, though the defaults consequent on such misconduct are not nearly so large as those resulting from speculations involving sums far greater than those at risk on games of hazard. They have found that when an employe has once yielded to temptation and defaulted, he is likely to again default. They have found that persons in positions of trust who live beyond their income, are likewise greatly exposed to the temptation of small peculation, particularly if addicted to immoralities and other excesses. They have found that a man's daily habits and associations determine very largely the likelihood as to whether or not he will continue the faithful discharge of his duties. They have further found that outside of and beyond these personal elements, the character of the supervision over the employe *for the prevention of default*, and the probability or improbability of an early discovery of any shortage, is a factor of the highest importance in determining whether or not it is likely that an employe will be guilty of his first embezzlement.

The largest defalcations are usually followed by statements from the unfaithful employe's superior officers that he was a too much trusted employe, who had been abstracting the funds intrusted to him for years.

Financial institutions do not procure bonds of suretyship to take the place of the duties incumbent upon the managers of such concerns, but to protect a risk ever present with the strictest supervision and the most approved system of keeping accounts.

The interest of the Bank and the Surety Company is identical. Each is interested and seeks to prevent a default; each is interested in the character of the supervision, and the lack of opportunity for default, and especially discovery before it becomes serious.

It is difficult to understand just how *any* conditions or provisions in such bonds having for their purpose the prevention of a default, or the detection of the same at the earliest possible time, and before it assumes any magnitude, are detrimental to the Bank accepting such bonds. Upon the contrary, it would appear to be more to the advantage of the Bank than the Company, as shown in the case at bar, the bond being an indemnity for only $10,000, while the default was more than $73,000. If the making of inquiries concerning the condition of the books of the employes results in requiring the Bank to make examinations to ascertain the information, this is more to the interest of the Bank than the Company, because any irregularities developed by such examinations should be known by the Bank.

Hence, all the conditions of the contract which merely require of the Bank what should be done without requirement, should commend themselves to the Court, and receive a fair and reasonable construction, looking to the intention and purposes of the contracting parties, and the contract as written.

Certain it is that no harsher or stricter rule should be applied in such cases than is applied in cases of other insurance, and particularly in cases of marine and fire insurance, which are very similar to suretyship or guarantee insurance in regard to the opportunity of information concerning the risk incurred. The rules governing life insurance should be administered even more strictly than in

suretyship insurance, for the reason that controversies regarding life insurance, involving the representations made to procure it, and the covenants regarding acts to be done on the part of the person whose life is insured, ordinarily do not arise until after the death of the person whose life is insured, and his representatives are cut off from the benefit of his testimony. In the case of suretyship insurance, when a claim for a loss has been made, both parties stand on an equal footing, regarding their knowledge and ability to testify as to the representations made and the performance of the covenants put on the person holding the insurance.

In fire and life insurance, the insured is frequently ignorant and unused to dealing with a more experienced man, able to take advantage of his ignorance. It frequently happens that, in such insurance, the insured is financially weak, and carries on an unequal struggle with an opulent opponent. In suretyship insurance, as a rule, the contrary is true. Persons and managers of corporations seeking such insurance are usually shrewd business men, abundantly able to take care of themselves in contracting, and ordinarily careful to know the terms of a contract, and scrupulous to see that they fulfill their part. In any suit that may arise with a guarantee company, they have ample resources, so as to leave nothing in their favor undeveloped.

Nor should too close a comparison be made between these *contract* bonds and bonds written for governments upon public officials. In the former the terms are mere matter of contract between private concerns. The risk assumed and the terms and conditions of the bond finally accepted is the result of negotiation between the contracting parties, each insisting upon such terms and conditions as appear desirable. Upon the contrary, public bonds, taken by surety companies, are not subject to change by contract, or otherwise; the law prescribes the exact terms of the bond, the character of supervision, and other safeguards for the prevention of default which inure to the benefit of the surety company without specific agreement therefor being inserted in the bond. In the one case the parties make their own agreement, in the other the law makes the agreement, which the surety company must accept or decline as tendered.

An examination in this case of the applications for, and the language of the bonds themselves, will show a purpose to make only a prudent inquiry into the surroundings of the employe, his opportunities for frauds, and the experience of the Bank with him preceding the application for the bond. The only conditions imposed are good faith and the exercise of such control and supervision of the employe, and examination of books and accounts, *for the prevention of default*, as would naturally be expected from reasonably well managed institutions without any requirement. These and similar requirements and conditions should be liberally construed and strictly enforced in the interest of a sound public policy.

II.

REPRESENTATIONS BY OFFICERS BINDING UPON THE BANK.

The representations of the president and cashier as to the examination of the employe's books and accounts, and with respect to the previous conduct of the employe were made for the Bank, and are binding upon it.

What is said by the Court in *American Surety Co.* v. *Pauly*, 170 U. S., 133, with respect to the representations of the president not being within the scope of his duties, makes it necessary to point out the distinction between that case and the case at bar.

In that case it was ruled that the act of the president, in certifying to the integrity, efficiency, and fidelity of the cashier, was not the act of the Bank, for two reasons. (1) It was no part of the duties of the president, and therefore he is not presumed to have disclosed to the Bank what he had done. (2) He and the cashier were confederates in the dishonesty of the cashier, for the purpose of defrauding the Bank, and hence is not presumed to have notified the Bank of what he had done. In that case the bond did not refer to the statement of the president, it did not appear that the Bank procured the bond, and it was not shown that the Bank was aware of representations made by the president. In the case at bar the facts are wholly different. There is no con-

tention in this case that either the president or cashier were the confederates of the bonded employe.

The cashier's bond refers specifically and accurately to the representations of the president; they are made a part of the bond, and it is recited that the statements are made on behalf of the Bank. The language of the bond is:

> "Now, therefore, this bond witnesseth, that the said employe, for and on his own behalf, and the said Company, fully relying on the truth of the statement and declaration contained in a certain document distinguished as Employer's Guarantee Proposal No. 154,806, dated the 10th day of January, 1893, and signed 'Lewis T. Baxter, President,' *on behalf of the said employer,* and lodged with the said Company at its office in Montreal, . . . do hereby . . . covenant with the said employer to reimburse unto the said employer."[1]

The teller's bond was not renewed until the *Bank* complied with the conditions imposed by the Company, which was thus stated to the *Bank:*

> "It is necessary before the bond can be renewed that you obtain the certificate on the back hereof by your president or cashier, and on its return with remittance of the premium, the renewal can be immediately effected."[2]

The premium for each bond was paid by the Bank, and it was so represented to the Company in each instance before the bonds were granted. In this case the Bank procured each bond, and had knowledge that the representations had been made for it by its proper officer. As long as the bonded employe was teller, these representations were made by the cashier. When he was elected cashier, the representations concerning him were necessarily made by the president.

[1] Trans., p. 7.

[2] Trans., p. 106.

As to the teller's bond, the *Bank* desired a renewal, and the Company declined to grant a renewal *until* the *Bank* should certify the result of the examinations made concerning the employe's books and accounts, and thereupon the Bank did make the representations through its cashier.

As to the cashier's bond, the contract made the statements of the president a part of the consideration, and stated that the representations of the president were made on *behalf of the bank.*

In the *Pauly* case the Court says:

> The presumption that the agent informed the principal of that which his duty and the interest of his principal required him to communicate does not arise where the agent acts or makes declarations not in execution of any duty that he owes to the principal, nor within any authority possessed by him, but to subserve simply his own personal ends, or to commit some fraud against the principal. In such cases the principal is not bound by the acts or declarations of the agent *unless* it be proved that he had at the time actual notice of them, or having received notice of them, failed to disavow what was assumed to be said and done in his behalf.

In this case, if the president exceeded his authority, and if his representations were beyond the scope of his duties, still the Bank had actual knowledge of his acts, and did not disavow what was assumed to be said and done on its behalf.

The language of the bonds in this case show clearly dealings between the Bank and the Company for the issuance of the bonds, and they are, in fact, contracts resulting from negotiations between the Bank and Company, and in which contracts the employe joins.

In the case at bar it is shown that the *Bank*, and not the employe, procured the suretyship bonds. The negotiation for them was between the Bank and the Company. This Court said in the *Pauly* case that these suretyship contracts are insurance contracts. If the Bank procures insurance upon its banking house against loss by fire, storm, or other contingency, it would certainly be within the scope of the officers' duties to make representations with respect to pertinent inquiries concerning the building. And if the Bank procures a contract of insurance against loss resulting from the fraudulent acts of its employe, it is equally within the

scope of the officers' duties to answer pertinent inquiries concerning the Bank's affairs and the employe. The Bank entered into the contract with the Company, and representations by its officers to the Company, which induced the making of the contracts, are clearly binding upon the Bank.

It is, therefore, confidently asserted that the question of the Bank's responsibility for the representations of its cashier and president, in procuring these contracts of indemnity, can not be the subject of dispute.

III.

SPECULATION.

The teller's bond was breached by the Bank in not reporting the speculation and disreputable habits of the bonded employe; and the cashier's bond was procured by a material misrepresentation as to his habits and associations.

This question of speculation is common to each bond, but applies in a somewhat different form. The teller's bond required immediate notice to the Company of the "employe being engaged in speculation or gambling, or indulging in any disreputable or unlawful habits or pursuits." The Bank procured the issuance of the cashier's bond by representing that it had not heard of and had not known of "anything unfavorable as to the habits or associations, past or present, of the employe." In the summer of 1892, during the currency of the teller's bond, and preceding the issuance of the cashier's bond in January, 1893, the Bank was told that the employe was speculating, and was a part owner in a "bucket shop." This information was confirmed to the Bank by the admission of the employe, and from other sources. The employe was told by a director and member of the finance committee of the Bank that "he ought to quit that or quit the Bank." The president of the Bank knew that the employe was afflicted with the fever of speculation, and still retained him in the employ of the Bank, without any investigation and without notice of the facts to

the Company, and induced it to issue the cashier's bond by withholding this information.

The former opinion of this Court thus states the facts:

> It is in evidence that information came to the president and directors of the Bank, through their cashier, that Schardt was a partner in what was called "a bucket shop," an agency for promoting speculation in small amounts upon the fluctuations of stocks, grain, cotton, and other commodities in which speculative gambling is done, and that he himself was speculating. When charged with this, Schardt admitted that he had taken an interest in such a partnership, but that he had sold out. He called his former partners to confirm his statement in this regard. He also admitted, according to one of the witnesses, at another time, that he had speculated to some extent, but asserted that he had always made gains and had seen the error of his ways and had stopped. Subsequently the cashier received an anonymous letter stating that Schardt was still speculating. He informed the president of the Bank. Schardt said it was a lie and no more attention was paid to it. All this occurred prior to the time when the president signed the guarantee proposal for the cashier's bond referred to. As a matter of fact, Schardt was speculating all the time, and lost the $100,000 he had stolen in gambling in futures.

The Circuit Judge thinks these facts, "when brought to the attention of the Bank officials, were a past event, and *apparently in itself unimportant.*" This Court had an "impression that this defense rests on circumstances *comparatively inconsequential.*" The Court further says: "There is no proof that Schardt ever confessed to speculation or gambling, except that of Sykes, who is somewhat discredited because he has a litigation with the Bank and an apparent animosity toward it." Eatherly, a director, and member of the finance committee of the Bank, interested financially with the Bank in this litigation, and called to testify for the Bank, says: "Subsequent to that, I went to Mr. Schardt's house to see him, having heard *again* that he was speculating. I told him what I had heard, and he said it was not so, that he did not own any stocks at all. I told him that if he was he ought to quit that, or quit the Bank, *and he said that he had sold everything he had.*"[1]

The statements of Sykes were not disputed, although he gave the names of all the parties, including the president of the Bank, who was not called to contradict Sykes.

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[1]Trans., p. 61.

Nor is it true that Sykes *thereafter* recommended him to the Company for a renewal of the teller's bond, or to the Bank as a suitable person to be his successor. The last renewal of the teller's bond was in January preceding; and Sykes merely stated, in reply to an inquiry, that Schardt had the *ability* to perform the duties of cashier. Nothing was asked or said with respect to his character.[1]

All these facts concerning the speculation of the employe were developed by the company. The able counsel for the Bank deemed it best for the Bank to wholly refrain from either introducing other witnesses to contradict what had been developed, or even to test the accuracy of what these witnesses stated. This resulted from no lack of interest in the question or want of ability. The name of the counsel representing the Bank is sufficient evidence of this fact. He, no doubt, was fully impressed with the idea that the least said was the best for his client, and that any effort to destroy the force of what the Company had developed could but make it stronger.

When the case was remanded to the Circuit Court, the Company filed a petition seeking to reöpen the case for further evidence upon this question of speculation, but the Court sustained the objection of the Bank, and declined to allow any further evidence.[2]

This question of speculation by an employe having the custody of trust funds, and the duty of the employer in such cases, is not a new one to the Courts.

PRESTON v. PRATHER.

137 U. S., 604.

This case involved the liability of a bank for the loss of bonds abstracted by its assistant cashier. The bank was held guilty of gross negligence, and liable as a gratuitous bailee, under the facts thus stated in the opinion of the Court:

It was shown that, about a year before the assistant cashier absconded, the defendant, Kean, who was the chief officer of the banking institution,

[1] Dep. Porter, cross-q. 7, Trans., p. 80.

[2] Trans., pp. 112, 117.

was informed that there was some one in the bank speculating on the Board of Trade at Chicago. Thereupon Kean made a quiet investigation, and the facts discovered by him pointed to Ker, whom he accused of speculating. Ker replied that he had made a *few transactions*, but was doing nothing then, and did not propose to do anything more, and that he was then about a thousand dollars ahead, all told. It was not known that Ker had any other property besides his salary. His position as assistant cashier gave him access to the funds as well as the securities of the bank, and he was afterwards kept in his position without any effort being made on the part of the defendants to verify the truth of his statement, or whether he had attempted to appropriate to his own use the property of others.

Again, about two months before Ker absconded, one of the defendants, residing at Detroit, received an anonymous communication stating that some one connected with the bank in Chicago was speculating on the Board of Trade. He thereupon wrote to the bank, calling attention to the reported speculation of some of its employes, and suggesting inquiry and a careful examination of its securities of all kinds. On receipt of this communication, Kean told Ker what he had heard, and asked if he had again been speculating on the Board of Trade. Ker replied that he had made some deals for friends in Canada, but the transactions were ended. The defendants then entered upon an examination of their books and securities, but made no effort to ascertain whether the special deposits had been disturbed. Upon this subject, the Court below, in giving its decision (29 *Fed. Rep.*, 498), after observing that the defendants knew that Ker had been engaged in business which was hazardous, and that his means were scant, and, after commenting upon the demoralizing effect of speculating in stocks and grain, as seen in the numerous peculations, embezzlements, forgeries, and thefts, plainly traceable to that cause, and the free access by Ker to valuable securities, which were transferable by delivery, easily abstracted and converted, and yet he being allowed to retain his position without any effort to see that he had not converted to his own use the property of others, *or that his statements were correct*, held that it was gross negligence in the defendants not to discharge him or place him in some position of less responsibility. In this conclusion we fully concur.

The exact language of Judge Gresham, thus approved by the Court, is:

It is immaterial, however, whether the defendants were bailees with or without reward, as in either case they are liable for the value of the bonds, the loss having resulted from their gross negligence. The defendants knew that Ker had been engaged in business which was hazardous, and that his means were scant. The demoralizing effect of speculating in stocks and grain — more properly speaking, gambling on the rise and fall of the price of stocks and grain — is seen in the numerous peculations, embezzlements, forgeries, and thefts plainly traceable to that cause. Ker had free access to valuable securities, which were transferable by delivery, easily

abstracted and converted; and yet he was allowed to retain his position without any effort to see that he had not converted to his own use the property of others, or that his statements were correct. A prompt examination, after his first admission that he had been speculating, would have doubtless shown that even then some of the plaintiff's bonds had been exchanged for others, if, indeed, they had not been stolen. Ker's position was one of trust and great importance. *His own admission showed that he was not trustworthy for such employment*, and it was *gross negligence* in the defendants not to discharge him, or place him in some position of less responsibility.

Prather v. Kean, 29 Fed. Rep., 502.

In *Scott* v. *National Bank of Chester Valley*, 72 Pa., 479, the fact that the employe was suffered to remain in the employ of the bank, after it was known that he had dealt *"once or twice"* in stocks, called forth the following language by the Court:

No officer in a bank, engaged in stock gambling, can be safely trusted, and the evidence of this is found in the numerous defaulters whose peculations have been discovered to be directly traceable to this species of gambling. A cashier, treasurer, or other officer having the custody of funds, thinks he sees a desirable speculation, and takes the funds of his institution, hoping to return them instantly, but he fails in his venture, or success tempts him on, and he ventures again to retrieve his loss or increase his gain — and again and again he ventures. Thus the first step, often taken without criminal intent, is the fatal step which ends in ruin to himself and to those whose confidence he has betrayed. Hence, *any* evidence of stock gambling or dangerous outside operations, should be visited with *immediate dismissal.*

This language was quoted with approval by the Court, in *Preston* v. *Prather* (*ibid*), and all these cases are referred to with approval by the Court of Appeals in Illinois.

Gray v. Merriam, 148 Ill., 179.

See also,

Merchants' Nat. Bank v. Guilmartin, 93 Ga., 503.

This subject of speculation has received the consideration of the Legislature and the Courts of Tennessee.

By Chapter 251, Acts of 1883, it is enacted:

That hereafter any sale, contract, or agreement for the sale of bonds, stock, grain, cotton, or other produce, property, commodity, article, or

thing for future delivery, when either of the contracting parties, buyer or seller, is dealing simply for the margin, or on the prospective rise or fall in the price of the article or thing sold, and when either of said contracting parties have no intention or purpose of making actual delivery or receiving the property or thing in species, shall be deemed, and is hereby declared, gambling.

Since 1883, a heavy license tax has been imposed upon such business, and in 1895 the tax was made $50,000 per annum.

In *Palmer & Cartwright* v. *State*, 88 Tenn., 553 (1889), it is held that the license tax does not legalize or protect the business from the criminal laws of the State, citing License Tax Cases, 5 Wall, 462, but is an additional burden upon the business.

In *McGrew* v. *City Produce Exchange*, 85 Tenn., 578, the Court, in construing the Act of 1883, above quoted, said:

This Act was intended to make it unlawful if either party had no intention of effectuating a real purchase or sale. It was designed to suppress the evil of dealing in futures, and to limit such operations to *bona fide* sales and purchases by those who wished to sell to those who intended to buy. In making the seller responsible for the intent of the buyer, and the buyer responsible for the intent of the seller, it intended to suppress gambling by confining the business of buying and selling for future delivery in such limits as would practically preclude the possibility of it. The *bona fide* dealer can still operate, but he can not do so upon any terms which do not protect the community against the pernicious and ruinous speculation in the rise and fall of prices.

ALLEN v. DUNHAM.

92 Tenn., 257.

In this case it appears from the opinion of the Court that Allen was teller in a Nashville bank, where the defendant in error was located. In May, 1890, he purchased, among other things, $90,000 of securities in one of these "bucket shop" concerns, but in the name of and through his outside friend, Dismukes. He became a defaulter and transferred his claim to recover money lost at gambling in this "bucket shop" to the bank, to secure his embezzlement. The bank thereupon sued the "bucket shop," and in the opinion of the Supreme Court, delivered at the December Term, 1892, after quoting what is above copied from the opinion in *McGrew* v. *City Produce Exchange*, it is said:

We add to what has already been so well said, that there is no evil more demoralizing and pernicious in its tendencies and consequences than the spirit of reckless speculation which pervades so largely all sections of our country, and all classes of society. It inevitably leads to peculation, embezzlement, and other crimes. It crushes legitimate business, and creates an unhealthy excitement, which brings ruin as its result. . . .

Now, what facts are developed in this case? We have a young man occupying an honorable and responsible position as bank teller, intrusted with the funds of the bank and its customers. Possessed with an unnatural desire to grow rich suddenly, he finds these defendants offering to him a field which he can enter for a comparatively small sum, and thereby become the ostensible owner and controller of stocks to an almost unlimited amount, subject to daily fluctuations, which, if favorable to him, would in one day realize for him more than he could earn in a year of hard labor at his legitimate work. Is it any marvel that he is induced to enter the inviting field?

It thus appears that at the time the defendant in error was receiving confessions from *its* teller that he was speculating and running a "bucket shop," and declining to notice anonymous communications warning them of his conduct in this respect, the example of a blighted life and a ruined institution, all caused by the speculation of a teller, was being rehearsed in the Courts in the same city; and the president of this Bank, with this startling example of the ruin and disgrace which inevitably follows in the wake of an employe handling trust funds and speculating, not only declines to heed the warnings of anonymous letters following the confession of the employe, but makes no investigation of the matter, gives no warning to the surety as required in the bond, and then represents that he has *never heard of anything unfavorable, past or present,* of this speculator and "bucket shop" dealer. He is not called to explain or deny any of these facts. He is not called to testify as to his honesty or good faith in this matter, and *yet* the Court trying this case has apparently attributed to him *both* honesty *and* good faith. No bank president, standing in the shadow of facts disclosed in the case of *Allen* v. *Dunham* (*ibid*), having knowledge of facts disclosed in this record, can be credited with having acted honestly or fairly with the surety Company in not reporting the speculation, as required in the teller's bond, and in representing such an employe worthy of confidence.

In the case at bar the confessed acts of the bonded employe

were far more serious than those of the employes in the above cited cases. Here the employe, without means, upon a salary of $100 per month, with his entire business career in the Bank, not only admitted having "speculated to some extent," but that he had, while teller of the Bank, become part owner of a "bucket shop," which is not merely acting as agent for others, but is the taking of all bets tendered by the public. *Allen* v. *Dunham* (*ibid*). It is the most demoralizing and the most vicious form of all speculation. And if it be gross negligence and want of good faith in a bank not to discharge an employe confessing to have made a "few deals," what will be said of the action of a bank retaining in its service an employe confessing to having speculated to some extent, and to having been part owner of a "bucket shop"? What process of reasoning can make it good faith upon the part of the president of the bank, possessed of such information, who represents to a proposed surety, that he has never heard or known of *anything* unfavorable concerning such an employe? How can good faith be accorded to the managing officers of a bank, who fail to report such knowledge of speculation and indulgence in such a disreputable pursuit as speculation and part ownership in a "bucket shop," when the bank is under contractual obligation to report such conduct to the surety of such an employe? How can any Court deem such information "apparently in itself unimportant"?

The Circuit Judge thinks that the *extent* of the speculation was not sufficient to require notice to the Company, and the Court of Appeals rather discredits the direct and positive evidence of Sykes, a witness unimpeached, uncontradicted, and sustained, if not by direct and positive testimony, certainly by circumstances of the greatest weight and importance. Eatherly, a director, and a member of the finance committee of the Bank, a witness offered by the Bank and interested in this litigation, says that Schardt told him in the presence of Baxter, the president of the Bank, that he had been part owner in a "bucket shop"; and on another occasion admitted that he had been speculating. It is not unreasonable that Sykes should have received the same information, aside from his positive and uncontradicted testimony.

The Court refers to the failure of the local agent of the Company to learn of the speculation of Schardt. What can be said of the action of the Bank in failing to discover the truth, having the knowledge of facts that made an investigation imperative, if neglect be attributable to the agent of the Company in not discovering the truth, who had no suspicion of the matter? The word of the employe was accepted by the Bank for the truth of the statement that he had ceased to speculate, without any independent investigation being made. The Company was deprived of the opportunity of making any investigation because of the failure of the Bank to give notice to the Company, as required by the bond, of the information it had.

With respect to the cashier's bond, the Company certainly had the right to know of this speculation and "bucket shop" dealing, when the president of the Bank was asked about the employe. If the confession of the employe to having made a "few deals" made it the imperative duty of the bank to discharge him; if it was gross negligence and bad faith in the bank to have retained him in a position of trust, how much the greater was the duty to discharge, and the bad faith in retaining him, when, in addition to the confession of a "few deals," the employe confessed to having had an ownership in a "bucket shop"? Was not this information unfavorable? Was it not discrediting? Can *any* bank president truthfully represent "to the best of his knowledge and belief," that he has not known of or heard of anything unfavorable of such an employe?

It was a breach of the written contract voluntarily entered into between the Bank and the Company in the case of the teller's bond, and a material misrepresentation in procuring the cashier's bond.

Beyond and above any amount of speculation as to why the Bank acted as it did, the fact remains that the Company desired to know of any speculation upon the part of the bonded employ, and hence stipulated for it; and the Bank breached the stipulation in not imparting the information it had.

As to the statement of the president that he had never heard of anything unfavorable as to the employe, which statement in-

duced the issuance of the cashier's bond, it is certain that he *had* heard of matters during the preceding year, which rendered the employe unworthy of confidence and demanded his immediate discharge. It is wholly immaterial why the president did not impart this information. He did, in fact, withhold the information which he had and was requested to give, and he is not called as a witness to explain his conduct, nor is any reason offered for not doing so.

Both the letter and spirit of the suretyship contracts were violated in this question of speculation and "bucket shop" dealings. The condition of the teller's bond was a reasonable one, having for its purpose the protection of the Bank as well as the Company. To construe it into a meaningless jumble of words, or into meaning such an improbable thing as notice only when the employe is apprehended in the very act of making a speculative deal, would not be in keeping with the ordinary meaning of the words used, nor the purpose had in view by the Bank and the Company in the making of this condition of the contract.

And the representation of the Bank's president that he had not heard of anything unfavorable as to the employe, can not be explained away upon any possible theory consistent with veracity, good faith, or a fair understanding. If, as this Court has said, it be *bad faith* to merely retain an employe in the service of the bank who has been speculating "to some extent"—"made a few deals," how can it be called *good faith* in one knowing such facts, and the additional fact of ownership in a "bucket shop," to represent that he knows nothing, past or present, unfavorable concerning the employe? Nor should the Court be called upon to invent an escape from the plain imputation of bad faith for Baxter, who, although accessible, is not called to explain for himself. If the Bank's counsel did not attempt to *explain* away this evidence with other witnesses, why should the Court endeavor to *reason* it away?

The representation of Baxter was in his official capacity, and for the benefit of the Bank in the scope of his duties, and is, therefore binding upon the Bank. The representation was material, and was false. The contract obtained under it can not be en-

forced. If the statements of the president were not authorized by the Bank, and were not in the apparent scope of his authority, the Bank adopted and ratified his act. The bond recited that the Company relied upon the statement of the president and specially referred to it as a part of the contract, and recited that the bond should be void upon the misstatement of a material fact.

It is universally held that when an employer knows the employe has been guilty of dishonest conduct, and conceals the information from the contemplated surety, the bond is void, whether inquiry be made by the intended surety or not.

Smith v. Bank of Scotland, 1 Dow., 294.
Phillips v. Foxall, L. R., 7 Q. B., 666.
Franklin Bank v. Cooper, 36 Me., 179.
Franklin Bank v. Stevens, 39 Me., 532.
Wayne v. National Bank, 52 Pa., 343.
Bostwick v. Van Voorhis, 91 N. Y., 353.
Clark v. Mfg. Ins. Co., 8 How., 335.

The reason assigned in all these cases is, that it is so little to be expected that an employer would continue in service such an employe, that it amounts to holding him out as a person of trust, and that this amounts to a fraud. If there be any unusual matter affecting the risk which the insured knows and the insurer may be ignorant of, then the information must be volunteered, even though not inquired about.

It is not necessary to go to that extent in this case, because here the direct inquiry was made by the Company,[1] and the answer made a part of the contract.[2] Hence, if the Bank concealed information or misrepresented what, if known, would have materially affected the risk, the contract is avoided. In this case the Bank both concealed and misrepresented the information it had touching Schardt's speculation and interest in a gambling concern. And the Courts hold that evidence of stock gambling, such as the Bank had in this case, rendered the employe wholly unworthy of trust, and *demanded his immediate dismissal.*

In contrast with the action of the Bank in not reporting the

[1] Stipulation, q. 4, Trans., p. 106.
[2] Cashier's bond, Trans., p. 7.

speculation to the Company, and in representing that nothing unfavorable, past or present, was known, is the action of the Company when it did receive notice of speculation, and the action of the Bank when the bond was canceled by the Company. Immediately upon learning that the employe had been speculating, the Company canceled the bond.[1] So soon as the Company did this, and notified the Bank why it did so, the Bank caused an examination of the books and accounts to be made.[2] The examination was scarcely begun when the stupendous frauds appearing on the books were discovered, and the wisdom of the rule of law announced by the Courts verified. The examination began with a trial balance from the individual ledger compared with the general ledger.

No explanation has been offered to justify or excuse the breach of the condition in the teller's bond, or the misrepresentation of the Bank in procuring the cashier's bond.

No recovery can be had under either bond.

IV.

MISREPRESENTATION OF CONDITION OF BANK BOOKS.

Each bond was procured by representing to the Company that the books and accounts of the employe had been examined and found correct to January, 1892, when the teller's bond was renewed, and to January, 1893, when the cashier's bond was issued. These representations were material and false.

When the teller's bond expired in January, 1892, the Bank applied for a renewal for another year. The Company replied that the bond could not be renewed until the Bank stated that the books and accounts of the employe had been examined and *verified*. Thereupon the Bank, through its cashier, made the representation that this had been done by the finance committee of the Bank to December 31, 1891. The bond was then renewed.

[1] Dep. Cooley, q. 3, Trans., p. 98.
[2] Dep. McEwen, cross-q. 1, Trans., p. 35.

When application was made for the cashier's bond in January, 1893, this Bank represented to the Company that the books and accounts of the employe had been examined to December 31, 1892, and found correct. The cashier's bond was then issued.

On December 31, 1891, the *books of the bank* showed the employe was a defaulter for the sum of $23,365.44, of which amount $19,600 represented understated liabilities, and $3,765.44 abstractions from the notes in a bank having only $50,000 capital.

It must be conceded that there was no *verification.* The only member of the committee testifying, admits that *Schardt's word was accepted* for the correctness of the amount appearing upon his books to be due depositors, and *admits there was a way* to *verify* the statement.[1] And, in this case, the comparison could and should have been made. The Bank, knowing that this verification *could* have been made, and that it was not made, *knew* that its statement to the Company that the books and accounts had been examined and *verified,* was false.

The statement was also false because there was no *examination.* The *assets* were no doubt examined, but the *books* were not. The assets were examined with a view to the *solvency* of the notes and collaterals, but the *amount* of the assets and the *amount* of liabilities *could not* have been examined.

It no doubt will be conceded that to open each book, glance at a page on each, and close them up, would not be an examination of such books; and scarcely more than this was done, because there was no comparison of ledger balances, and no correct footing of the notes in the Bank.

The representation was that the books and accounts *had been examined and verified, not* that the employe was supposed to be honest and correct in his accounts; *not* that the Bank believed that an examination would disclose no shortage; *not* that the Bank had sufficient confidence in the integrity of Schardt to suppose an examination unnecessary. Whatever idea may have been entertained by the Bank with respect to the correctness of its own affairs, it is nevertheless true that the Bank, without qualification,

[1] Dep. Eatherly, cross-qq. 60, 61, and 67, Trans., pp. 57, 58.

represented that it had done a particular thing when it had not done so.

The first thing that would suggest itself to an examining committee would be to compare ledger balances, especially as this was the only means of ascertaining even approximately, whether the books were correct; and it is equally plain that a correct comparison should be made between the aggregate amount of notes in the Bank and the amount called for by the books of the employe intrusted with the collection of the notes. It can not be that a bank committee supposed that an examination of the books of the Bank consisted in asking the employe how much assets he should have, and then counting the assets to see that they agreed with the amount the employe said he should have; and yet it appears that this Bank scarcely did this, because the notes of the Bank were less than the amount the books of Schardt called for. No doubt some of the finance committee did have meetings as represented. No doubt they examined the notes, stocks, bonds, etc., held by the Bank, but this was done with a view of determining the solvency and value of the securities. The committee, supposing Schardt to be honest, did not deem an examination of his books necessary. The Bank *may* have supposed the representation that the books had been examined and verified a mere form; but it was not a form; it was a question of fact, and was false.

One of the committee says they looked to the cashier, who was an expert bookkeeper, to see that the books of the Bank were kept correctly.[1] The cashier, Sykes, says he never had anything to do with the examination of the books.[2] No member of the committee has testified that he did not know how such examinations could have been made, and no one of them had the courage to say he was ignorant of what should have been done. The only one who does testify concerning what was done says they had Schardt's word for the correctness of the false account.[3]

On December 31, 1892, the *books of the bank* showed the employe was a defaulter for the sum of $73,715.44, of which amount

[1] Dep. Jno. A. McEwen, qq. 4 and 10, Trans., pp. 90, 91.
[2] Dep. Sykes, cross-qq. 5 and 7, Trans., p. 79.
[3] Dep. Ratherly, cross-q. 61, p. 57.

$69,700 represented understated liabilities, and $4,015.44 abstractions from the notes in a bank having a capital of only $50,000.

When this purported examination was made in December, 1892, the Bank knew the employe had been speculating "to some extent" and had been part owner of a "bucket shop." Whatever may be said of the former examinations, this knowledge made a careful examination imperative.

When the teller's bond was renewed in January, 1892, the situation of the parties was this: The employe upon whom the bond was desired had occupied the position of teller in the Bank since 1888. The only means of knowing the fidelity with which he had handled the funds of the Bank was to make inquiry of the Bank. The officers and directors were assumed to be reasonably prudent men. If a reasonably prudent examination failed to disclose any default, the Company could afford to renew the bond. The inquiry was made, and answered by the Bank, and the bond renewed. Upon the other hand, the books of the Bank were out of balance $19,600. The notes in the Bank were less by $3,765.44 than called for by the books kept by the employe, who was also the custodian of the notes. The universal, and indeed the *only* way to examine the books of the Bank was to compare the balance on the books kept by Schardt with the balance on the books kept by the individual bookkeeper. This comparison would have disclosed the shortage. The correct footing of the notes in the Bank compared with the amount called for on the books kept by the bonded employe would have disclosed the shortage. It is customary in all banks to compare trial balances every thirty days. It was customary to do this in this Bank until 1890, but after that it was never done. At any time within three years prior to the failure of this Bank, a comparison of trial balances would have detected this shortage of the bonded employe. The cashier of the Bank during all this time was an expert accountant and a member of the finance committee making the examinations.[1]

When the cashier's bond was issued in January, 1893, the situation of the contracting parties was this: Schardt had been in the Bank from 1887 to January, 1893. The only information obtain-

[1] Dep. McEwen, qq. 6 and 10, Trans., pp. 90 and 91.

able with respect to his business habits and integrity was through the Bank. He had just been elected cashier, and the Bank desired a bond in the sum of $20,000. The Company desired certain information before assuming the risk. It applied to the Bank. Within the keeping of the Bank was his business career of the six preceding years. The official report showed the Bank to have been well managed, so well, in fact, that its accumulated surplus exceeded the half of its entire capital. It was, therefore, not negligent for the Company to assume that its officers were reasonably skillful bank officials. If Schardt had properly and honestly handled the funds of the Bank for more than five years, the presumption would be that he was an honest employe and worthy of the risk to be assumed by the Company. If irregularities in his accounts had existed to any appreciable extent, the Bank would have detected it, assuming the books and accounts had been examined. If he had been guilty of default or misconduct, the Bank would have observed it in the course of so long a period.

The Company was unwilling to issue this bond without making such inquiry. Therefore, knowing that such information could only be obtained from the Bank, it made the inquiry as to whether the books and accounts had been examined, and, if so, whether they were found correct. This statement of the Bank in reply to the inquiry was expressly made a part of the contract.

No explanation has been offered by the Bank to explain why these examinations were not prudently made. The record does not present any fact or circumstance to show good faith or prudent conduct upon the part of the Bank officials.

It is quite true that several months were consumed by the expert accountants in ascertaining the *exact amount* of the shortage, but only a *few hours'* examination of the *bank books* were necessary to discover that there was a *very large default*[1]

It is also true that there were certain *items* of the default which required the calling in of all pass books and a very searching investigation to ascertain the *exact* amount of the Bank's loss. But all these items may be eliminated in the discussion of this case, since they nearly all occurred after January 1, 1893. Complaint

[1] Dep. McEwen, cross-q. 5, p. 36.

is directed to the failure of the Bank officers in detecting the enormous losses *apparent upon the books of the Bank;* and the failure to discover *some part* of the many errors in the Bank *books,* which could have been discovered with the *slightest* examination. Whatever was shown upon the face of the Bank books, revealing the shortage, should have been known, and why it was not known has received no satisfactory answer, either in the record or in the argument of counsel. And this failure becomes the more startling when the depositions of the Bank officers are considered.

Eatherly seems to have been the head and front of all examining committees of the Bank. He undertakes to show how very careful and scrutinizing he was at all times in making examinations. He would have the Court understand that he was careful and even exacting, and he is convincing in his efforts to show that he not only knew just *what* should be done, but just *how* to do it. And yet the astonishing fact remains that the shortage was *not* discovered, *although* the *simplest* and *only possible* examination could not fail to have disclosed the loss.

These officers do not plead ignorance and good faith, but knowledge and the performance of duty. They do not ask to be excused upon a plea of failure to discover the loss because they did not know what they *should* do, and therefore did all they *knew how,* but they show that they knew all about bank examinations and insist that they did in fact make thorough investigations, and yet the failure to discover the loss remains a mystery. There is eliminated from the discussion all the errors not discoverable except by calling in pass books, failure to enter deposits upon the books, failure to enter money collected, and failure to enter notes discounted, yet after eliminating all these, there remains a shortage, December 31st, 1891, when the examination was made to procure the last renewal of the teller's bond, of $23,365.44; and on December 31st, 1892, when the examination was made upon which the cashier's bond was procured, there was a shortage of $73,715.44. *All this shortage appeared upon the books of the Bank.*

The total shortage, as finally fixed, was on January 1st, 1892, $28,167.34. Of this amount, $23,365.44 was apparent upon the

bank books, consisting of $19,600 less deposits on the books kept by Schardt than was shown on the individual ledger, and $3,765.44 less notes owned by the Bank than the amount called for on the Bank books.

In the same manner, the total shortage, as finally fixed, was on January 1st, 1893, 78,817.24. Of this amount, $73,715.44 was apparent upon the Bank books, consisting of $69,700 less deposits on the books kept by Schardt than was shown on the individual ledger, and $4,015.44 less notes owned by the Bank than the amount called for on the Bank books.[1]

Now, *after* January 1st, 1893, Schardt did embezzle the funds of the Bank in almost every imaginable way, but all this is beside the question, since the last examination, affecting the rights of the Company, was made December 31st, 1892, when the cashier's bond was procured, and on December 31st, 1891, when the last renewal of the teller's bond was procured.

The effort is made to show how very difficult it would have been to compare ledger balances, which comparison at any time in three years preceding the failure of the Bank would have disclosed the shortage. Witnesses are introduced to show what a long time it would have taken to procure a trial balance from the individual ledgers for comparison with the general ledger balance, which would have revealed the default. One witness says it would have taken twelve hours, another twenty-four to thirty-six, yet the bookkeeper who *did* take off these balances before they were discontinued in the latter part of 1890, says that he *always* did so between the close of business one day and the opening of business the next.[2]

When this teller's bond was renewed in January, 1892, it was, in legal effect, the making of a new contract of insurance.

Biddle on Insurance, Sec. 341.
May on Insurance, Sec. 70a.

The Supreme Court has thus defined the duty of bank directors:

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[1] Trans., q. 43, p. 42.
[2] Dep. Boench, q. 13, p. 76.

We hold that directors must exercise ordinary care and prudence in the administration of the affairs of a bank, and that this includes something more than officiating as figureheads. They are entitled under the law, to commit the banking business, as defined, to their duly authorized officers, but this does not absolve them from the duty of reasonable supervision.

Briggs v. Spaulding, 141 U. S., 132.

The Supreme Court of Tennessee has thus stated their duty:

Directors, by assuming office, agree to give as much of their time and attention to the duties assumed as the proper care of the interests intrusted to them may require. If they are inattentive to these duties, if they neglect to attend meetings of the board, if they turn over the management of the business of the company to the exclusive control of other agents, thus abdicating their control, then they are guilty of gross negligence with respect to their ministerial duties; and if loss results to the corporation by breaches of trust or acts of negligence committed by those left in control, which by due care and attention on their part could have been avoided, they will be responsible to the corporation. The diligence required from them has been defined as that exercised by prudent men about their own affairs, being that degree of diligence characterized as ordinary. If a less degree of diligence is exercised, the negligence is gross, and for losses consequent he is liable.

Wallace v. Lincoln Savings Bank, 5 Pickle, 652.

The Company had the right to assume that the directors of this Bank had done what the law required of them, and that they had at least exercised ordinary diligence in the conduct of the Bank.

The duty of the paid officers of the Bank must be greater than this. And when the books of the Bank clearly show a large default, easily discoverable by the exercise of the most ordinary examination, the failure of the paid officers to discover the default is more than mere neglect. The cashier was an expert accountant.[1] The *only* way the examinations could *possibly have been made* would have shown the default.

The information sought by the Company, and the representations made by the Bank with respect to these examinations, were matters peculiarly and exclusively within the knowledge of the Bank. The Company had the right to rely upon its representa-

[1]Dep. McEwen, q. 4, Trans., p. 90.

tions, and for that reason the duty of knowing and telling the truth was imperative.

Pom. Eq. Jur., Sec. 888.
Morse on Banks, Sec. 21.
Biddle on Insurance, Sec. 462.
Cooley on Torts, Sec. 499.
Trimble v. Reid, 31 S. W. Rep., 861 (Ky.).
Franklin Bank v. Cooper, 36 Me., 179, 197.
Graves v. Lebanon National Bank, 10 Bush., 23.

The last case cited is somewhat similar to the one at bar, except that the surety in that case was an individual; but the law of the case must be the same, whether the surety be an individual or an insurance company. Whatever differences there may be between these two classes of sureties, it is not with respect to the principle laid down in that case. There may be a difference with respect to the duties and obligations imposed by the terms of the contract where the sureties are individuals, which may be governed by somewhat different principles from cases in which an insurance company is the surety. In the latter class of cases the courts may presume that all the conditions and duties to be performed by the beneficiary are embraced in the contract, while in the former cases the courts may be more liberal with respect to matters which release the sureties from their obligation. And in another respect, with individual sureties, the obligation may be more strictly construed that in cases where insurance companies become sureties, but *no* case can be found in which the rights of the sureties are in any respect different, whether they be individuals or insurance companies, with respect to the release of the sureties because of material misrepresentations. In the last case cited, the Court says:

A fraud may be perpetrated as well by the assertion of facts that do not exist, ignorantly made by one whom the person acting upon the assertion has the right to suppose has used reasonable diligence to inform himself, as by concealing facts known to exist, which, in equity and good conscience, ought to be made known.

We have, therefore, a case in which the directory of the bank held out to others as a trustworthy officer, a man who had been guilty of repeated embezzlements and frauds, all of which might have been discovered by the exercise of slight diligence.

This case was affirmed in *Deposit Bank* v. *Hearne*, 48 S. W. Rep. 160. (Ky., 1898.)

In the case at bar, the officers not only had in their employ an employe who has been guilty of repeated embezzlements, all of which might have been discovered by the exercise of slight diligence, but facts touching his conduct which imperatively required his immediate dismissal, and a most careful examination of his accounts. Yet no careful examination was made, but the statement to the proposed surety *was* made that the books and accounts *had* been examined and *had been found correct.* The slightest examination would have shown the default. Not one page of the books was correct, and the incorrectness was apparent upon each page. Neglect, in such case, is followed by all the consequences of bad faith. "If," in the language of *Knapp* v. *Bailey*, 79 Me. 195, "a party has knowledge of such facts as would lead a fair and prudent man, using ordinary caution, to make further inquiry, and he avoids the inquiry, he is chargeable with notice of the facts which, by ordinary diligence, he would have ascertained. He has no right to shut his eyes against the light before him. He does a wrong in failing to heed the signs and signals seen by him. It may be well concluded that he is avoiding notice of that which he, in reality, believes or knows."

A statement recklessly made, without knowledge of its truth, is a false statement, knowingly made.

Cooper v. Schlisinger, 111 U. S., 148.
Nevada Bank v. Portland Bank, 59 Fed. Rep., 338.

In *Mouler* v. *Ins. Co.*, 111 U. S., 335, it is said:

> Looking into the application upon the faith of which the policy was issued and accepted, we find much justifying the conclusion that the company did not require the insured to do more, when applying for insurance, than observe the utmost good faith, and deal fairly and honestly with it in respect of all material facts about which inquiry is made, and as to which he has, or should be presumed to have, knowledge or information.

In the case at bar the Bank held out as trustworthy an employe who had been guilty of repeated embezzlement, all shown upon his books. The Bank represented that these books had been ex-

amined and found correct. The facts were exclusively within the keeping of the Bank, and its representation could not be verified elsewhere. This information was sought for the purpose of deciding upon the issuance of the bond, and the Bank was informed of this purpose.

These material misrepresentations prevent a recovery under either bond.

V.

SUPERVISION OF EMPLOYE AND INSPECTION OF BANK BOOKS.

The Bank failed to observe the conditions of the teller's bond requiring an annual inspection or audit of the books and accounts; and to observe all due and customary supervision over the employe for the prevention of default.

These defenses apply alone to the teller's bond. The bond states:

> "The following provisions are also to be observed and binding as a part of this bond:
>
> "That the employer shall observe, or cause to be observed, all due and customary supervision over the said employe for the prevention of default.
>
> "That there shall be an inspection or audit of the accounts and books of the employe, on behalf of the employer, at least once in every twelve months from the date of this bond."

The condition with respect to supervision for the prevention of default is not thought by counsel for the Bank to refer to the books and accounts of the employe, but "supervision personally of the employe."

If the condition of the bond refers personally to the employe, then there was a clear failure of the Bank to examine into the conduct of the employe when he admitted having speculated, and having been part owner in a "bucket shop," and also when additional

information was received by anonymous letters that he was still speculating. If an examination had been made at this time, the statement of the employe that he had sold out and quit speculating would have been shown to be false, because he was, during all this time, speculating and embezzling the funds of the Bank.

The contention of the Company is that the language used in the bond is unambiguous, and means just what it says; that is, all due and customary supervision, and the purpose of the condition is expressed in the words "for the prevention of default." In other words, the Company agreed to reimburse the Bank any loss resulting from the default of the employe, upon the condition that the Bank would exercise all due and customary supervision over the employe *for the prevention of default.* The condition is analogous to the language of fire insurance contracts prohibiting the storage of combustibles, requiring precautions against fire, and requirements looking to the protection of the property against fire. It is analogous to conditions in life policies looking to the preservation of good health.

What interest could the Company have in requiring examinations other than to prevent a default? And hasn't the Company the right to require supervision to prevent the default, if there be one, becoming larger by continued neglect, and thus by failing to detect the dishonest employe, enable him to continue his dishonest acts?

The condition was neither harsh nor hostile to the interests of the Bank. The temptation and opportunities were sought to be limited by requiring all due and customary supervision, so that the risk assumed by the Company would not be so great; and did not contemplate the cessation of the duty imposed by law upon the Bank to use all due and customary supervision over the employe to prevent losses by the stockholders and creditors of the Bank. Upon the contrary, the condition of the bond made it clear that the Company intended the Bank to fully understand that if all due and customary supervision for the prevention of default was not exercised, it would not be responsible to the Bank.

The Company did not undertake the unnecessary and uncalled for risk of protection to the Bank against losses occurring because

of the lack of due and customary supervision by the officers of the Bank, but only the losses that might result *after* the exercise of this supervision. The indemnity was to protect the Bank against loss that could not be prevented where the legal duty of the Bank officials was exercised. The Bank officers could not abandon their duty to exercise all due and customary supervision over the employe for the prevention of default, and the Company did not contract to assume such a risk. The contract was mutual, the Bank was to exercise due and customary supervision for the prevention of default, and the Company was to be responsible for any loss resulting *after* this supervision was exercised. If the condition of the bond does not mean this, it does not mean anything at all, and is mere surplusage. This construction is reasonable, and is clearly the intention of the contracting parties. If the Bank was bound under this condition of the bond to exercise all due and customary supervision over the employe for the prevention of default, the question of what is due and customary supervision only remains to be determined. The law has already determined what this is. Ordinary care and attention is the test even for directors, and much greater care and attention from the paid officers of the Bank. Citation of authorities is unnecessary for this proposition.

If, however, the condition of the bond does not refer to such supervision as the law requires, but refers to the supervision exercised in this Bank when the bond was obtained, or the supervision exercised by other banks generally, the result is the same. The facts show that neither the supervision exercised in this Bank when the bond was procured, nor the supervision exercised generally by other banks, nor the supervision required by law to be exercised, was, in fact, exercised by this Bank and no ingenuity can suggest any plausible theory of what supervision was contracted for, which will show a compliance with this condition upon the part of the Bank. And an examination of the facts in the record will verify the statement that due and customary supervision, in whatever sense the words could have been used, was not, in fact, exercised by the Bank over the bonded employe.

The facts in the record show that up to 1890 it was customary in this Bank to compare ledger balances as often as every thirty

days, but that thereafter no comparisons were ever made;[1] and that the employe commenced to abstract the funds of the Bank as soon as this supervision ceased.[2] When this bond was originally procured this supervision prevailed in the Bank. It then and now universally prevails in all other banks, and is the only possible way banks have of knowing anything about their condition, and in no other way can the books of the bank be kept in balance, or their condition be known.[3]

The first act of supervision would be to see that the books in the Bank were kept in balance. This was not done during the entire year. At the beginning of the year they were out of balance $19,600; at the end of the year, $69,700 — nearly twice the capital of the Bank, and nearly one-half the total deposits.[4]

The next act of due supervision would be to see that the assets called for by the Bank's books were in the Bank. At the beginning of the year the notes in the Bank were $3,765.44 less than the books called for; at the end of the year they were $4,015.44 less.[5] The total amount of the notes in the Bank were less than $200,000.

The by-laws of the Bank required the cashier to see that all the accounts and books of the Bank were properly kept.[6] The cashier, during the whole of 1892, was an expert bookkeeper.[7] He states that he was never present at any examination, and merely copied the statement of assets and liabilities from the daily balance book as his report to the directors.[8] Although an expert bookkeeper, he did not exercise sufficient supervision over the books of the Bank to see that they were in balance. Starting at the beginning of the year out of balance $19,600, they ran up to $69,700 at the end of the year, yet the expert bookkeeper, charged by the rules of the Bank with this duty, failed to supervise them sufficiently to discover that they were out of balance at all.

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[1] Dep. Boench, q. 6, p. 75.
[2] Trans., p. 15.
[3] Dep. Harris, p. 74; Dep. McLaughlin, p. 80; Dep. Duncan, pp. 84–86; Dep. Fischer, p. 89.
[4] Dep. McEwen, cross-q. 43, Trans., p. 42.
[5] Dep. McEwen, cross-q. 43, Trans., p. 42.
[6] Dep. Pryor, q. 11, Trans., p. 70.
[7] Dep. McEwen, q. 4, Trans., p. 90.
[8] Q. 7, Trans., p. 79.

It is certain that "due and customary supervision *to prevent a default*" was not exercised by the Bank.

This record affords a very striking illustration of the necessity of due supervision of employes to prevent a default. This employe was honest and faithful *until* the Bank *ceased* to exercise due supervision. The books were kept in balance until just before the defalcation commenced. The ledger balances were compared each thirty days, and made to agree. So soon as this act of supervision *ceased,* the defalcation *commenced.*

With respect to the other condition of the bond requiring an inspection and audit of the books and accounts at least once a year on behalf of the employer, it is not contended that the finance committee did not *partially* examine the *assets* of the Bank, no doubt with a view of declaring dividends, but there was no "inspection or audit of the *books and accounts of the employe*" during the year 1892. This language clearly contemplates a reasonable, careful, and prudent examination of the books and accounts of the employe in order to ascertain their condition. There is not a page of the books kept by the employe during the year 1892 that is correct, and that could not have been found to be false if examined.

The words "inspection or audit" have a meaning well understood. They have no reference to the financial condition of the Bank. They refer to the particular books and accounts kept by this employe, and *these* books and accounts were required to be examined. There is no pretense that this was done, and hence this condition of the bond was breached.

VI.

ERROR IN AMOUNT OF DEFAULT.

If the Court should be of opinion that there should be a recovery under the cashier's bond, it is important to call attention to an error in the amount of the default claimed to have occurred during the life of this bond.

This bond only undertakes to indemnify the Bank against the default of the employe "constituting embezzlement or larceny."

The only evidence of the default is the report and depositions of the expert accountants who examined the affairs of the Bank, and in their report is included $5,992.35 "of overdrafts allowed and not authorized.[1]

This may have constituted a fraudulent act by the employe, but it certainly can not be either embezzlement or larceny. Under no construction of the terms of the bond can this amount be deemed a part of the loss sustained by the Bank for which it can make claim against the Company.

The Court of Appeals, in its opinion, says:

> Objection is made to an item included in the report of the expert bank examiners, on which the decree was rendered, of $5,992.35 of "overdrafts allowed and not authorized." It is insisted that this was not embezzlement or larceny. *We do not know whether it was or not.* It *might* be, because embezzlement or larceny may be committed through the process of overdrafts. This question was not made by exceptions or passed on in the Circuit Court, and was, it is said by counsel, only brought to attention there at the time the decree was entered. It is evidently an afterthought, and there being *no proof showing the facts in relation to the overdrafts,* nor why they were by the examiners included, neither the trial Court nor this Court can say they were *not embezzlements* or larcenies. There is no proof to sustain this objection, which comes too late.

If the Court refers to the statement of the experts in speaking of a failure of plaintiff in error to except to their report, it is respectfully submitted that the Court is mistaken in assuming that this report of experts was made under the direction or decrees of the Court. They were merely accountants employed by the Bank officials to examine the affairs of the Bank for their own use, and they were introduced as witnesses to testify to the result of their examination.

It is respectfully submitted that it is incumbent upon the Bank to show a loss within the plain and unambiguous language of the contract. The experts could have no competent knowledge of the matter except the books of the Bank. They report overdrafts *allowed, and not authorized.* Since the Court is unable to say that this is "embezzlement or larceny," is it not failure on the part of the claimant to make out a case? If the Court can look to the

[1] Trans., p. 47.

statement of counsel, which is outside the record, still there was no exception to make by plaintiff in error. All that it could do was to insist that the item should not be allowed. There was no report to file exceptions to, and the statement of counsel that the attention of the trial judge was directed to the point before final decree, is sufficient evidence that the question was not an afterthought, raised in the Appellate Court for the first time. What else could have been done by counsel upon the hearing, except to insist that the item should not be allowed? The bond did not undertake to protect the Bank against fraud, bad judgment, and all kinds of dishonesty, but only losses sustained which constituted "embezzlement or larceny." When claim is made for a loss it should affirmatively appear that the loss comes within the character of loss contracted against, and not require the Company to show that a loss has not been sustained. The expert accountants were not supposed to know what particular defaults were contracted for, and, no doubt, were entirely ignorant of the terms of the contract.

VII.

CONCLUSION.

It is apparent from the record and the defenses urged by the Company to defeat a recovery under each bond, that each and every defense is based upon matters affecting the merits of the risk assumed. Each and every one of them relate to matters which were of the essence of the contracts. They are not technical, do not relate to matters occurring after the loss, but they concern matters which were intended to, and which would have prevented loss to the insured, if observed in any degree of prudence and care.

No greater care, and no higher degree of skill is insisted upon by the Company than such as reasonably prudent bank officers usually possess and exercise. The Company does not insist that the Bank officials should have exercised any more prudence and good faith in dealing with it than the prudence and good faith

legally and morally required of bank officials in all other dealings between them and other persons. But this much is insisted upon, and should be sustained by the Court. And the record abundantly shows that the officers of this Bank were intelligent and *knew* what their duty was, even though they did not perform it.

The loss would not have occurred if the Bank had observed *any* supervision, much less "all due and customary" supervision over its employe. The Bank would not have procured either bond, if it had reasonably examined the books and accounts of the employe, and have correctly represented the facts. The Bank would have been saved from insolvency, if it had reported the speculation and "bucket shop" dealings of the employe, as it agreed to do and had not accepted the statements of the employe without any independent investigation; and the cashier's bond would never have been obtained, if the Bank had not withheld the information it had touching the disreputable conduct and habits of its employe. The Bank obtained each bond, not through ignorance, but through neglect and bad faith, and it should not be permitted to profit by that same neglect and bad faith.

If the bad faith of the Bank is not shown in *each* of these defenses, certainly it is shown when *all* the defenses are considered together. The record discloses that the Bank did *nothing at all* to comply with its part of these contracts, and obtained them by reckless and untrue statements.

A sound public policy demands that bank officers be required to exercise good faith and reasonable prudence in the conduct of affairs intrusted to them, and it would be contrary to public policy, and greatly detrimental to the public interest, for the rule to be established that the officials of corporations can dispense with all care in overlooking employes under them if they hold a bond for a fraction of the amount which such employes may embezzle.

If the holding of the Court in this class of cases is to be that the employer, in seeking such bond, is not bound to make disclosure of such facts as may be known to him affecting the reliability of the employe sought to be bonded, even when asked in regard thereto by the bonding company, and that an answer which can by any possibility be excused as not being in bad faith, shall not

be deemed a misrepresentation avoiding the bond, and that, *after procuring such a bond,* the employer is bound to no duty and to no diligence in regard to a supervision of the employe, and all stipulations looking toward requiring the disclosure of discrediting facts known to the employer, either at the time of the issuance of the bond or becoming known to him thereafter, or stipulations regarding the supervision of the employe, are to be construed against the company with the utmost strictness and harshness, it will have the effect to increase greatly the hazard and risk of the business to the companies engaged therein, and will result in the permanent injury and loss to the public seeking such bonds, by requiring large increases in the premiums paid therefor, to cover the additional hazard and risk so incurred. It will tend to the relaxation of the duties required by law of all bank officers, and can but be detrimental to the interests of the creditors and stockholders.

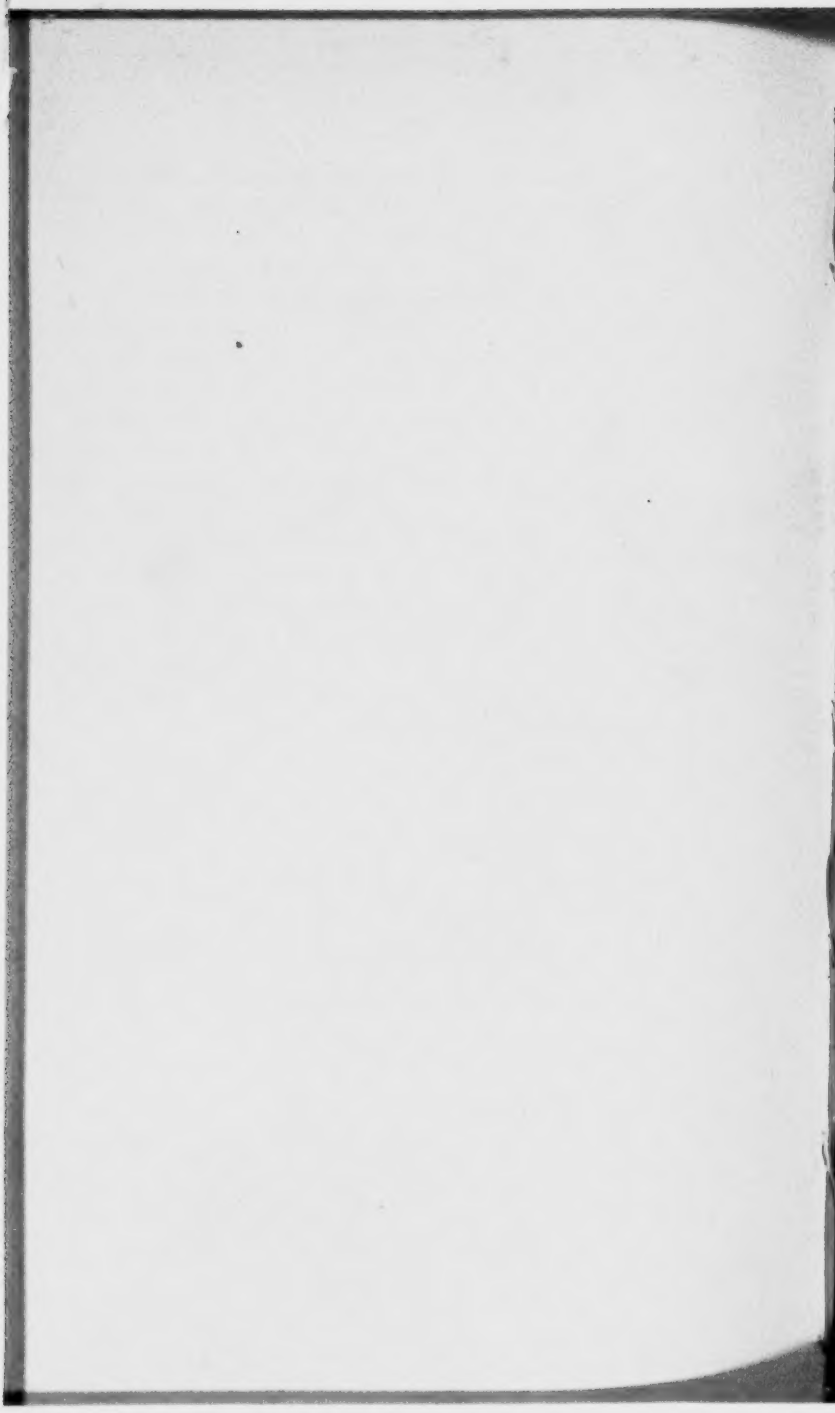
The decree of the Circuit Court should be reversed with direction to dismiss the bill.

Respectfully submitted,

WILLIAM L. GRANBERY,

Counsel for Plaintiff in Error.

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No. 261.

Br. of Granbery for Petitioner

Office Supreme Court U
FILED
MAR 11 1901
JAMES H. McKENNEY,
Clerk

NO. 261.

Filed Mar. 11, 1901.

Supreme Court of the United States

OCTOBER TERM, 1900.

THE GUARANTEE COMPANY OF NORTH AMERICA
PETITIONER.

VS.

MECHANICS' SAVINGS BANK & TRUST COMPANY
For use of James J. Pryor, Assignee, Etc.

On Writ of Certiorari to the Circuit Court of Appeals for the Sixth Circuit.

BRIEF OF
WILLIAM L. GRANBERY,
SOLICITOR FOR PETITIONER.

In the Supreme Court of the United States,

OCTOBER TERM, 1900.

GUARANTEE COMPANY OF NORTH AMERICA,
PETITIONER,

VS.

MECHANICS SAVINGS BANK & TRUST CO., FOR USE, ETC.

On Writ of Certiorari to the Circuit Court of Appeals for the Sixth Circuit.

STATEMENT.

May it please Your Honors:

This cause is now before your Honors for hearing in obedience to a writ of certiorari granted at the last term, and directed to the Circuit Court of Appeals for the Sixth Circuit, requiring it to send to this Court a transcript of the record and proceedings, to the end that its decree might be reviewed in this Court.

The litigation originated in a State Court by bill in equity by the Mechanics' Savings Bank and Trust Company, for the use of J. J. Pryor, Assignee, seeking to have an account stated between it and its former teller and cashier, John Schardt, to adjust certain equities between these parties, and to recover upon two bonds of suretyship issued by the Guarantee Company of North America to the Bank, upon Schardt, first as teller, and later as cashier of the Bank.

The case was seasonably removed to the United States Circuit Court at Nashville, Tennessee; and upon a hearing a decree was

rendered against the company under each bond.[1] Upon appeal, the decree of the Cricuit Court was affirmed.[2] The case was then brought to this Court by certiorari, and the decree of the Court of Appeals was reversed and the cause remanded because the decree of the Circuit Court was not a final one.[3] When the case had been remanded an unsuccessful effort was made by the company to have the cause reopened for additional evidence discovered since the first decree of the Circuit Court. Thereupon, after certain proceedings, under which its exact liability was ascertained, a final decree of $40,050 was rendered against the company.[4]

On appeal to the Circuit Court of Appeals for the Sixth Circuit, the decree of the Circuit Court was slightly modified and affirmed.[5] Application for a writ of certiorari was again made to the Court in April, 1900, and was allowed in May, 1900. The case is now before the Court for hearing in obedience to that writ. The controversy now involves the liability of the Guarantee Company to the Bank under its two bonds of suretyship.

The Mechanics' Savings Bank and Trust Company, hereinafter called the "Bank," was a banking institution located at Nashville, Tennessee, with a capital stock of $50,000.[6] John Schardt was its teller from 1888 to January 1, 1893, when he was elected cashier, and remained such until his death, on April 17th, following. As teller and cashier he embezzled more than $100,000 of the funds of the Bank, beginning in 1890, and continuing until about the time of his death. About the time that Schardt died, the Bank, ascertaining its insolvency, closed its doors and made a general assignment for the benefit of its creditors.[7]

The Guarantee Company of North America, hereinafter called the "Company," is a corporation organized under the laws of the Dominion of Canada, for the purpose of guaranteeing pecuniary losses occasioned by the fraudulent acts of persons in positions of trust, and has been so engaged in Canada and the United States

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[1] 68 Fed. Rep., 459.
[2] 47 U. S. Appeals, 91.
[3] 173 U. S., 587.
[4] Trans., p. 99.
[5] Trans., p. 104.
[6] Dep. Eatherly, q. 11, Trans., p. 43.
[7] Bill, Trans., pp. 1-5.

since 1872. In 1888 it issued to the Bank a bond, for a period of one year, on Schardt as teller, for $10,000, which was subsequently renewed each year until January, 1893, when it issued a bond on Schardt as cashier for $20,000. Generally speaking, each bond insured the Bank, under certain limitations and conditions, against pecuniary loss by reason of the fraudulent acts of Schardt in the respective offices held by him.

This defalcation of more than $100,000 was entirely lost in speculation,[8] and at the death of Schardt he had practically no property, but about $80,000 of life insurance, all of which he assigned to the Bank just prior to his death, to secure his defalcation. From these collaterals the Bank realized the sum of $46,838.46,[9] and for the remainder of the default the Company was held liable to the extent of each bond. Upon the appeal the Court ascertained the default under the cashier's bond to have been only $16,971.82, instead of $22,964.17, as ascertained by the Circuit Court, and modified the decree of the Circuit Court accordingly.[10]

In all other respects the decree of the Circuit Court was affirmed. The Company contests any liability under either bond, for the following reasons:

PROVISIONS IN EACH BOND.

In re Teller's Bond.

This bond states:

> "The following provisions are also to be observed, and binding, as part of this bond:
>
> [1] "That the employer shall at once notify the Company, on his becoming aware of the said employe (Schardt) being engaged in speculation or gambling, or indulging in any disreputable or unlawful habits or pursuits.
>
> [2] "That the employer shall observe, or cause to be observed, all due and customary supervision over the said employe for the prevention of default."

[8] Dep. Eatherly, q. 29, Trans., p. 44.
[9] Trans., p. 98.
[10] Trans., p. 106.

> [3] "That there shall be an inspection or audit of the accounts and books of the employe on behalf of the employer at least once in every twelve months from the date of this bond." [11]

The original issue of this bond expired in January, 1889, and thereafter in January of each succeeding year. Before the bond was renewed each year the Company furnished the Bank with a blank form to be filled out, which provided as follows:

> "It is necessary, before the bond can be renewed, that you obtain the certificate hereon of your president or cashier, and on its return, with remittance of the premium, the renewal can be immediately effected."

The Bank executed and delivered the required certificate at the end of each year, and paid the premium of $100, which effected a renewal for the succeeding year. The certificate was filled in and signed by the cashier of the Bank, and among other things it stated that the accounts of said teller, Schardt, "had been examined and *verified* by the finance committee of the Bank"; and the bond was not renewed any year until this certificate had been made out and delivered to the Company.[12] The last renewal of this bond was in January, 1892.

In re Cashier's Bond.

In January, 1893, when the teller, Schardt, was elected cashier of the Bank, an application was made to the Company for a bond of $20,000, and before agreeing to issue it the Company required of the Bank answers to certain questions, which were addressed to Lewis T. Baxter, president, and distinguished as "Employer's Guarantee Proposal." In asking the questions it was stated: "In order that the directors of the Company may be fully informed in deciding upon the proposal, it is desired that the answers be as full and definite as possible, for mutual protection." Among other questions, all of which were answered by the president of the Bank on its behalf, were the following:

"*Q.* 2. If a *new* employe, by whom was the ap-

[11] Trans., pp. 9-12.

[12] Stipulation, Trans., pp. 86-89.

plicant introduced, or how did he become known to you? If hitherto in continuous service, for how long, in what capacities, and has he uniformly performed his *duties* faithfully and satisfactorily?

A. Applicant began service in this bank six years ago as collector clerk, and has since been advanced to Bank's teller, and now cashier.

Q. 3. Has he ever been in arrears or default in the Bank's service, or, as far as you have heard, in any previous employment?

A. No.

Q. 4. Have you known or heard anything unfavorable as to his (Schardt's) habits or associations, past or present? No.

Or of any matters concerning him about which you deem it advisable for the Company to make inquiry? No.[13]

Q. 9. Amount of bond hereby required, from what date to commence, and by whom premium will be paid?

A. Twenty thousand dollars, to date from January 1, 1893, premium payable by Bank.

Q. 10. What further security, if any, will be held or required from applicant?

A. None.

Q. 13. When were applicant's books and *accounts* (including cash, securities, and vouchers, if any), last examined, and by whom?

A. December 31, 1892, by finance committee of Bank (were they correct?), and found correct.

The above answers and representations are true to the best of my knowledge and belief." [14]

The cashier's bond was thereupon executed and delivered to the Bank, and among other things provided:

"Now, therefore, this bond witnesseth, that the said employe, for and on his own behalf, and the said Company, fully relying on the truth of the

[13] Trans., p. 90.

[14] Stipulation, Trans., p. 91.

statement and declaration contained in a certain document, distinguished as Employer's Guarantee Proposal No. 154,806, dated the 10th day of January, 1893, and signed 'Lewis T. Baxter, President,' on behalf of the said employer, and lodged with the said Company at its office in Montreal, . . . do hereby . . . covenant with the said employer to reimburse unto the said employer, etc."

"This bond is granted upon the following express conditions:

"1. Any misstatement of a material fact in the declaration within named, or in any claim made under this bond, will render this bond void from the beginning.

3. That any written answers or statements made by or on behalf of said employer in regard to or in connection with the conduct, duties, actions, or methods of supervision of the said employe, delivered to the Company either prior to the issue of this bond, or to any renewal thereof, or at any time during its currency, shall be held to be a warranty thereof, and form a basis of this guarantee, or of its continuance." [15]

SPECULATION.

Schardt was a heavy speculator. Within less than two years his losses amounted to over $100,000. So imbued was he with the fever of speculation that he became part owner of a "bucket shop," or brokerage concern. In the summer of 1892, during the time the last renewal of the teller's bond was in force, and before the issuance of the cashier's bond, Sykes, the then cashier of the Bank, was informed of the conduct of the teller in this regard, and at once notified Baxter, the president of the Bank. Schardt was questioned on the next day, and admitted that at one time he had been interested in such concern, but had sold out his interest. He also admitted that he had been speculating to some extent, but had ceased to do so. Substantially the same things were stated by Schardt to Eatherly, a director and member of the finance com-

[15] Trans., P. 8.

mittee of the Bank. Some time thereafter, and prior to January 1, 1893, when the cashier's bond was issued, Sykes, cashier, received an anonymous letter again informing him that Schardt was speculating. This was also laid before the president of the Bank. Eatherly also received an anonymous letter giving him similar information, which he showed to the president.

The entire testimony upon this question of speculation is here set out in detail:

TESTIMONY OF CHARLES SYKES.[16]

Q. 5. Were you cashier of the Bank during the whole of the year 1892?

A. Yes, sir.

Q. 6. Did you, at any time during that year, receive information that John Schardt was speculating? If so, state when, how, and all the circumstances.

A. Yes, sir; I did receive such information. Sometime in the summer or fall of 1892 a gentleman by the name of Kyle came here from New York, representing Myers & Co., of New York. Kyle wanted me to become interested in the brokerage business and represent Myers & Co. at this point. I told him that I did not like the idea, because it would be purely a speculative business, and he then said that made no difference, that John Schardt, our teller, was a partner in a similar concern.

Q. 7. Did you impart this knowledge to any one? If so, whom?

A. Yes, sir; I at once told Mr. L. T. Baxter, the president of the Bank, of the conversation.

Q. 8. Did you say anything to Schardt about the matter?

A. Yes, sir; on the next day, I think, I told Mr. Schardt of what Mr. Kyle had said.

Q. 9. What did Schardt say to you in reply?

[16] Trans., p. 64-5.

A. He admitted that he had at one time been interested in such a concern, but had sold his interest; and that he had speculated to some extent, but had made money on every transaction, and had seen the error of his way, and had ceased to do so any more.

Q. 10. Did you impart this information received from Schardt to anyone connected with the Bank? If so, to whom?

A. Yes, sir; I immediately told Mr. Baxter, the president of the Bank, what Schardt had said.

Q. 11. Did you receive any other information at any other time, with reference to Schardt speculating?

A. Yes, sir; some time thereafter I received an anonymous letter, telling me that Schardt had been speculating.

Q. 12. What did you do with it, and what became of it?

A. I showed it to Mr. L. T. Baxter, the president, and he said not to pay any attention to an anonymous letter; and I spoke to Schardt about it, and he said he thought he knew the author, and asked me to let him have the letter and he would bring the party before me and make him acknowledge it was false.

Q. 13. Did you give him the letter, and did he bring the party before you?

A. I gave him the letter, and asked him about it more than once, and he always replied that he was working on it.

Q. 14. Did you tell Mr. Baxter of this conversation?

A. I think I did.

Testimony of J. M. Eatherly.[17]

DIRECT EXAMINATION.

Q. 2. State what have been your relations with

[17] Trans., p. 42.

the Mechanics' Savings Bank and Trust Company for several years past.

A. I was a director in the Bank from its organization until its assignment.

Q. 3. Did you fill any other position?

A. For a considerable length of time I was on the finance committee, and for about twenty days I was president of the Bank.

Q. 4. Please state what twenty days you were president.

A. I was elected on the 28th of March, 1893, and the Bank assigned on the 17th of April.

Q. 8. During what time were you on the finance committee?

A. I was, for several years, and prior to my election as president.

CROSS-EXAMINATION.[18]

Q. 98. Did you ever hear of Schardt's speculation before January, 1893?

A. I think I did.

Q. 99. Did you see the anonymous letter written with respect to his speculating?

A. I saw a letter directed to Judge John Woodard. Judge Woodard brought that letter to the Bank and showed it to me, and I asked permission to call Mr. Schardt up and show it to him, and he said that he was perfectly willing that I should do so. I at once called Mr. Schardt to where we were, and told him there was a communication I wanted him to read. He did so, and his remarks were: "It's a lie, and I can prove it!" In this letter it was stated that Mr. Schardt was a partner in a bucket shop. I told Mr. Schardt that it devolved on him to prove it false. I at once reported the contents of this letter to the president of the Bank, Mr. Baxter. Mr. Schardt asked that I and Judge Woodard remain there for a few minutes. He went out and

[18] Trans., p. 51.

got Frank Searight and Dr. Barry. Judge Woodard, Mr. Baxter, and myself went into the rear of the Bank building. Mr. Schardt and the other gentlemen came back, and Mr. Schardt says: "Here are the men who can tell you whether that is so or not." I asked them if they knew why we had sent for them, and they said Mr. Schardt had told them. Mr. Searight said that, some time before, Mr. Schardt, Dr. Barry, and himself had agreed to open a brokerage association. They objected very much to the term "bucket shop." Each one was to put in a small amount, $200, I think. Mr. Schardt in a short time became dissatisfied, and sold his interest to Frank Searight at a small loss. Subsequent to that I went to Mr. Schardt's house to see him, having heard again that he was speculating. I told him what I had heard, and he said that it was not so; that he did not own any stocks at all. I told him if he was he ought to quit that or quit the Bank, and he said he had sold everything he had. I again heard that he was speculating, but from sources that I did not attach any importance to, as it all emanated from the same source as the anonymous letter. I again approached him, and he denied it.

TESTIMONY OF THEO. COOLEY.[10]

Q. 3. Did the defendant Company at any time cancel its bond on John Schardt while he was cashier of the complainant company? If so, when, and for what reason?

A. Yes, sir; the Company did cancel its bond through me, as its agent, the Saturday before the Bank assigned on Monday. The cause which led to this action was that I had ascertained that John Schardt had been speculating in futures, and I so reported to the Bank when the bond was canceled.

Q. 9. Did you know or hear of Schardt's specu-

[10] Trans., p. 82.

lations prior to the time mentioned above when you received such information?

A. I did not.

Q. 10. Have all matters pertaining to the issuance of the bonds upon Schardt in favor of the complainant passed through your hands as representative of the Company?

A. They have, so far as I know.

Q. 11. Is it or not a part of your duties to gather information concerning applicants for bonds, and about persons already bonded in the defendant Company, in this part of the country?

A. Yes, sir.

Q. 12. Do you transmit such informatoin to the home office of the Company?

A. I do.

Q. 13. If the Company had received any information with respect to Schardt's speculations, or other information unfavorable to him, would you have been advised of the fact by the Company?

A. I would, as that is the usual method of doing business.

All of the above testimony was brought out by counsel for the Company, and not one question, direct or indirect, was asked by counsel for the Bank of any one of these or other witnesses, to either contradict or vary what had been brought out by counsel for the Company upon this question of speculation. Whatever was developed along this line for the Company was allowed to rest without any effort to vary or contradict the same.

No information concerning this speculation was, at any time, furnished the Company or its agent at the place where the Bank was located.

BANK BOOKS.

There was kept in the Bank an individual ledger, which showed in detail the deposit account of each depositor. This book was kept by a clerk who had no other duties, and was known as the "individual bookkeeper." Schardt had nothing to do with the keeping of this book. There were three other books, all kept by

Schardt: (1) A general ledger, showing generally the accounts of the Bank, including the total deposits, but not in detail the accounts of depositors. There was kept in this book an account of demand loans, discounts, bonds, stocks, etc. It purported to show the total deposits paid in and those checked out each day, *and purported to show at the end of each day's business the aggregate amount due to depositors.* (2) A daily balance book, which showed a summary of each account in the general ledger. It showed on each page, at the end of each day's business, all the assets and liabilities of the Bank under appropriate heads; it showed the amount of notes, cash, stocks, bonds, etc., owned by the Bank, and the amount the Bank owed *depositors*, other banks, bills payable, etc. (3) A cash book, in which each day's business was grouped on one page, instead of putting the business of each day under the various accounts, as in the general ledger, each page of the cash book showing the entire business transacted that particular day, each page beginning with the cash on hand at the opening of the Bank any particular day would be debited with all the receipts for the day, and showing from what source derived, and would be credited with all disbursements and showing on what account made. These were the principal and only material books kept in the Bank.[20]

All money drawn from the Bank was by check; and all money coming into the Bank was upon deposit tickets. Schardt, as teller, paid the checks, charged them to the deposit account on the general ledger, and then passed them to the individual bookkeeper, who in turn charged them to each depositor drawing the checks. In like manner, Schardt, as teller, received money accompanied by deposit tickets, credited deposits on the general ledger, and passed them to the individual bookkeeper, who in turn credited them to each depositor's account. It is thus seen that the individual ledger and general ledger were made up from the same information, and hence the aggregate amount due depositors on the individual ledger, and the general ledger balance, showing the amount due depositors, should at all times have agreed, the individual ledger showing the amount due *each* depositor, and the general ledger the aggregate amount due *all* depositors.[21] These balances were

[20] Dep. McEwen, cross-q. 4, Trans., p. 30.
[21] Dep. Boench, q. 9, Trans., p. 63.

compared and made to agree as often as every thirty days, until just before Schardt commenced to abstract money, in the latter part of 1890. After that time no comparisons were ever made,[22] although it is customary in all banks to have them made as often as every thirty days.[23]

The individual and general ledger were out of balance January 16, 1891, $2,098; January 1, 1892, $19,600, and on January 1, 1893, $69,700.[24]

The individual ledger was properly kept, and correctly showed the amount due to each depositor.[25]

The general ledger was *not* properly kept, and after the latter part of 1890 did *not* correctly show the amount due to depositors. It was not correct because Schardt, as teller, *abstracted the funds of the Bank*, and *understated* on the general ledger the amount due to depositors by the amount he had abstracted to that date. And the difference in the balances represented a shortage by Schardt of that amount at the respective dates.[26]

On April 15, 1893, the Bank employed an accountant to examine Schardt's books.[27] He, by merely comparing the individual and general ledger balances, ascertained and reported the embezzlement to the Bank.[28]

Schardt also abstracted proceeds of notes paid to him as teller. *His books were not falsified to conceal this character of shortage*, but the amount of notes in the Bank did not equal the amount called for on Schardt's books by the amount he had abstracted. This character of shortage continued for three years prior to the assignment.[29]

On January 1, 1892, when the Bank procured a renewal of the teller's bond by representing to the Company that his books and accounts had been examined and *verified*, the bank books kept by

[22] Dep. Boench, q. 6, Trans., p. 63.
[23] Dep. Fischer, q. 4, Trans., p. 74; Dep. Duncan, q. 12, Trans., p. 70; Dep. McLaughlin, q. 5, Trans., p. 67; Dep. Harris, cross-q. 4, Trans., p. 62.
[24] Dep. McEwen, cross-q. 43, Trans., p. 35.
[25] Dep. McEwen, cross-q. 42, Trans., p. 35.
[26] Dep. McEwen, cross-q. 24, Trans., p. 31.
[27] Dep. McEwen, cross-q. 1, Trans., p. 31.
[28] Dep. McEwen, cross-q. 5, Trans., p. 31.
[29] Dep. McEwen, cross-q. 37 and 43, Trans., p. 35.

Schardt *showed* that he was a defaulter for $23,169.34; of this shortage $19,600 was abstracted deposits, and $3,765.44 proceeds of notes collected and not accounted for, as shown on the books of the Bank.[30] On January 1, 1893, when Schardt was made cashier, and the bond on him as such was procured to be issued, by the Bank representing to the Company that his books and accounts had been *examined* to that date and found *correct,* his shortage was $78,819.24; of this amount $69,700 was abstracted deposits, and $4,015.44 proceeds of notes collected, all of which was apparent upon the books of the Bank.[31] The capital of the Bank was $50,000.[32]

ASSIGNMENT OF ERRORS.

TELLER'S BOND.

1. The Bank agreed to immediately notify the Company on becoming aware of the employe being engaged in speculation, and the Bank learned that the employe had not only been speculating, but had been part owner in a gambling concern, and neither investigated the matter on its own account, nor notified the Company.

2. The Bank procured the teller's bond to be renewed in January, 1892, by representing that the employe's books and accounts had been examined and *verified,* when the *books of the Bank showed a default of* $23,365.44, in a bank with a capital of only $50,000.

3. The Bank agreed to "observe, or cause to be observed, all due and customary supervision over the said employe *for the prevention of default,*" and during the currency of the bond ceased to compare ledger balances, or correctly count the notes held by the Bank, which was not only customary with other banks, but was customary in this Bank up to the time this shortage commenced.

4. The bond provided that there should be "an inspection or audit of the accounts and books of the employe on behalf of the employer at least once in every twelve months," yet the ledger balances were not compared, and the notes in the Bank were not counted or compared with the amount called for by the books;

[30] Dep. McEwen, cross-q. 43, Trans., p. 35.
[31] Dep. McEwen, cross-q. 43, Trans., p. 35.
[32] Dep. Eatherly, q. 11, Trans., p. 43.

every page in the books kept by him was incorrect; and no inspection or audit of his books or accounts was made.

CASHIER'S BOND.

1. The Bank represented that it did not know of and had not "heard of anything unfavorable as to the habits or associations, past or present," of the employe upon whom it was seeking the issuance of the bond; yet at the time the Bank, *and the particular officer, making the statement for the Bank, knew* that the employe had been engaged in speculation, and had been a partner in a gambling concern, while occupying a position of trust in the Bank, and no effort was made to verify his statement that he had sold out his interest in the "bucket shop" and had ceased speculating.

2. The Bank procured the issuance of the cashier's bond by representing that the books and *accounts* of the employe, who had been its teller for five years, had been examined and found correct to the end of his term of office; yet at that time the *books of the Bank showed a default* of $73,715.44, in a bank with a capital of only $50,000.

Each of the above assignments of errors, under both bonds, was determined against the Company in the Circuit Court, and in the Court of Appeals.

The opinion of the Circuit Judge is reported in 68 Fed. Rep., 459; that of the Court of Appeals in 47 U. S. App., 91. The opinion of the Court of Appeals on the second appeal merely adopts its first opinion with respect to all the defenses now insisted upon.

BRIEF AND ARGUMENT.

I.

GENERAL PRINCIPLES.

This Court has quite recently announced the rules of construction applicable to this form of insurance contracts:

* If, looking at all its provisions, the bond is *fairly* and *reasonably* susceptible of two constructions, one favorable to the Bank and the other favorable to the Surety Company, the former, *if consistent with the objects for which the bond was given,* must be adopted, and this for the reason that the instrument which the Court is invited to interpret was drawn by the attorneys, officers or agents of the Surety Company. This is a well established rule in the law of insurance. *Nationanl Bank* v. *Insurance Co.* 95 U. S., 673; *Western Ins. Co.* v. *Cropper,* 32 Penn. St., 351, 355; *Reynolds* v. *Commerce Fire Ins. Co.,* 47 N. Y., 597, 604; *Travelers' Ins. Co* v. *McConkey,* 127 U. S., 661, 666; *Manchester, etc., Life Ass'n,* 3 B. & S., 917, 925. As said by Lord St. Leonards in *Anderson* v. *Fitzgerald,* 4 H. L. Cas., *483, *507, "it [a life policy] is of course prepared by the company, and if therefore there should be any ambiguity in it, must be taken, according to law, most strongly against the person who prepared it." There is no sound reason why this rule should not be applied in the present case. The object of the bond in suit was to indemnify or insure the Bank against loss arising from any act of fraud or dishonesty on the part of O'Brien in connection with his duties as cashier, or with the duties to which in the employer's service he might be subsequently appointed. That object should not be defeated by any narrow interpretation of its provisions, nor by adopting a construction favorable to the Company *if* there be another construction *equally* admissible under the terms of the instrument executed for the protection of the Bank.

American Surety Co., v. Pauly, 170 U. S., 133.

In *Travelers' Insurance Co.* v. *McConkey* (*ibid*) it is said:

Such being the contract, the Court must give effect to its provisions according to the *fair* meaning of the words used, leaning, however—where the words *do not clearly* indicate the intention of the parties—to that interpretation which is most favorable to the insured.

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* Italics added.

To these rules of construction, natural and reasonable as all must admit, no criticism can be made. Under these rules, words and sentences will not be "parsed" into something beyond any rational meaning. Nor will Courts speculate upon what particular words and phrases may or might mean, where there is a natural and usual meaning attached to them, easily understood, and not *fairly and reasonably* susceptible of two constructions, and *clearly* indicating the intention of the parties.

As was said by the Court in *Holmes* v. *Insurance Co.*, 39 C. C. A., 45, "We recognize in the fullest manner the binding obligation of these settled canons of construction. But when, as in the case at bar, there is no ambiguity in the policy, and no inconsistent or conflicting provisions and nothing requiring construction or interpretation, there is no room for their application."

Whatever conditions are contained in the contract will be upheld and enforced by the Court:

In *Imperial Insurance Co.* v. *County of Coos*, 151 U. S., 452, Mr. Justice Jackson, delivering the opinion, says:

> Contracts of insurance are contracts of indemnity upon the terms and conditions specified in the policy or policies embodying the agreement of the parties. For a comparatively small consideration the insurer undertakes to guaranty the insured against the loss or damage upon the terms and conditions agreed upon, and upon no other; and when called upon to pay, in case of loss, the insurer, therefore, may justly insist upon the fulfillment of these terms. If the insured can not bring himself within the conditions of the policy he is not entitled to recover for the loss. The terms of the policy constitute the measure of the insurer's liability, and in order to recover, the assured must show himself within those terms; and if it appears that the contract has been terminated by the violation, on the part of the assured, of its conditions, then there can be no right of recovery. The compliance of the assured with the terms of the contract is a condition precedent to the right of recovery. If the assured has violated or failed to perform the conditions of the contract, and such violation or want of performance has not been waived by the insurer, then the assured can not recover. It is immaterial to consider the reasons for the conditions or provisions on which the contract is made to terminate, or any other provision of the policy which has been accepted and agreed upon. It is enough that the parties have made certain terms conditions on which their contract shall continue or terminate. The Courts may not make a contract for the parties. Their function and duty consists simply in enforcing and carrying out the one actually made.

An analysis of all the reported cases upon the subject of insur-

ance, it is confidently believed, will sustain the following propositions:

The cases may be divided into two great classes, (1) cases involving matters arising *prior* to the loss, and (2) cases involving matters happening *after* the loss. In the latter class of cases all Courts have applied a strict construction to any defenses under which liability is denied. In this class of cases, the defense involves a forfeiture of meritorious rights, and an honest and just cause of action is sought to be defeated by technicalities.

The first class of cases may be subdivided into two classes, (1) cases involving the construction of the contract, and (2) matters affecting the conduct of the contracting parties in the procurement and execution of the contract. In all matters involving the construction of the contract, the Courts always favor the insured, for well settled reasons. But *with respect to all other matters* the Courts do not favor *either* party, and in this respect there is nothing peculiar to insurance contracts, but Courts deal with them as they do other contracts, requiring the same honesty and fair dealing as in all other matters of every day concern in business affairs.

The proposition may be stated differently. In the consideration of the *merits* of a controversy, involving an insurance contract, Courts will no more permit an unjust advantage to be taken by the insured than they would in the consideration of any other contract. Good faith and honesty, truthfulness and carefulness, are as much required of the insured as the insurer. Representations or conduct affecting the contract and being material, are not applied to insurance contracts differently from other classes of contracts. The insured will not be permitted to derive an advantage from his negligence, carelessness or misrepresentations, any more than he would be permitted so to do under any other form of contract.

These obligations are peculiarly applicable to guarantee insurance, as will be pointed out herein. Before doing so, however, the purposes for which such insurance is applied for and obtained should be clearly understood.

This Court knows judicially that the most prudent and conservative financial institutions, exercising the strictest supervision, require their employes occupying positions of trust to be bonded against any fraudulent conduct involving a loss to the institution.

No supervision, however careful or thorough, can prevent losses of this character. No system of keeping accounts, or examinations, can eliminate this risk. The most that can be expected is to discover the fraud before the loss becomes serious. Hence it is that only bonds for sufficient amounts to cover this character of risks are required and accepted. The amount of the bond is but a small percentage of what the employe may have access to in the usual course of his employment, but by exercising due and customary supervision, and with a proper system of examinations, the chance of any default becoming serious before discovery is minimized. Experience teaches that honest men rarely become dishonest in a day. Temptation, when first encountered, is easily resisted; with each succeeding encounter the power of resistance is weakened. Defaults are small in the beginning, and gradually increase to enormous amounts, if not sooner detected. Persons of experience and observation have found that persons in positions of trust who speculate in stocks, grain, cotton, provisions, and like commodities, invariably, lured on by the hope of retrieving past losses, become defaulters to large amounts. They have further found that persons in positions of trust who are in the habit of gaming will, sooner or later, become losers, and, in consequence, defaulters, though the defaults consequent on such misconduct are not nearly so large as those resulting from speculations involving sums far greater than those at risk on games of hazard. They have found that when an employe has once yielded to temptation and defaulted, he is likely to again default. They have found that persons in positions of trust who live beyond their income, are likewise greatly exposed to the temptation of small peculation, particularly if addicted to immoralities and other excesses. They have found that a man's daily habits and associations determine very largely the likelihood as to whether or not he will continue the faithful discharge of his duties. They have further found that outside of and beyond these personal elements, the character of the supervision over the employe *for the prevention of default*, and the probability or improbability of an early discovery of any shortage, is a factor of the highest importance in determining whether or not it is likely that an employe will be guilty of his first embezzlement.

The largest defalcations are usually followed by statements

from the unfaithful employe's superior officers that he was a too much trusted employe, who had been abstracting the funds intrusted to him for years.

Financial institutions do not procure bonds of suretyship to take the place of the duties incumbent upon the managers of such concerns, but to protect a risk ever present with the strictest supervision and the most approved system of keeping accounts.

The interest of the Bank and the surety Company is identical. Each is interested and seeks to prevent a default; each is interested in the character of the supervision, and the lack of opportunity for default, and especially discovery before it becomes serious.

It is difficult to understand just how *any* conditions or provisions in such bonds, having for their purpose the prevention of a default, or the detection of the same at the earliest possible time, and before it assumes any magnitude, are detrimental to the Bank accepting such bonds. Upon the contrary, it would appear to be more to the advantage of the Bank than the Company, as shown in the case at bar, the bond being an indemnity for only $10,000, while the default was more than $73,000. If the making of inquiries concerning the condition of the books of the employes results in requiring the Bank to make examinations to ascertain the information, this is more to the interest of the Bank than the Company, because any irregularities developed by such examinations should be known by the Bank.

Hence, all the conditions of the contract which merely require of the Bank what should be done without requirements, should commend themselves to the Court, and receive a fair and reasonable construction, looking to the intention and purposes of the contracting parties, and the contract as written.

Certain it is that no harsher or stricter rule should be applied in such cases than is applied in cases of other insurance, and particularly in cases of marine and fire insurance, which are very similar to suretyship or guarantee insurance in regard to the opportunity of information concerning the risk incurred. The rules governing life insurance should be administered even more strictly than in suretyship insurance, for the reason that controversies regarding life insurance, involving the representations made to procure it, and the covenants regarding acts to be done on the part

of the person whose life is insured, ordinarily do not arise until after the death of the person whose life is insured, and his representatives are cut off from the benefit of his testimony. In the case of suretyship insurance, when a claim for a loss has been made, both parties stand on an equal footing, regarding their knowledge and ability to testify as to the representations made and the performance of the covenants put on the person holding the insurance.

In fire and life insurance, the insured is frequently ignorant and unused to dealing with a more experienced man, able to take advantage of his ignorance. It frequently happens that, in such insurance, the insured is financially weak, and carries on an unequal struggle with an opulent opponent. In suretyship insurance, as a rule, the contrary is true. Persons and managers of corporations seeking such insurance are usually shrewd business men, abundantly able to take care of themselves in contracting, and ordinarily careful to know the terms of a contract, and scrupulous to see that they fulfill their part. In any suit that may arise with a guarantee company, they have ample resources, so as to leave nothing in their favor undeveloped.

Nor should too close a comparison be made betwen these *contract* bonds and bonds written for governments upon public officials. In the former the terms are mere matter of contract between private concerns. The risk assumed and the terms and conditions of the bond finally accepted is the result of negotiation between the contracting parties, each insisting upon such terms and conditions as appear desirable. Upon the contrary, public bonds, taken by surety companies, are not subject to change by contract, or otherwise; the law prescribes the exact terms of the bond, the character of supervision, and other safeguards for the prevention of default which inure to the benefit of the surety company without specific agreement therefor being inserted in the bond. In the one case the parties make their own agreement, in the other the law makes the agreement, which the surety company must accept or decline as tendered.

An examination in this case of the applications for, and the language of the bonds themselves, will show a purpose to make only a prudent inquiry into the surroundings of the employe, his opportunities for frauds, and the experience of the Bank with him

preceding the application for the bond. The only conditions imposed are good faith and the exercise of such control and supervision of the employe, and examination of books and accounts, *for the prevention of default*, as would naturally be expected from reasonably well managed institutions without any requirement. These and similar requirements and conditions should be liberally construed and strictly enforced in the interest of a sound public policy.

II.

REPRESENTATIONS BY OFFICERS BINDING UPON THE BANK.

The representations of the president and cashier as to the examination of the employe's books and accounts, and with respect to the previous conduct of the employe were made for the Bank, and are binding upon it.

What is said by the Court in *American Surety Co.* v. *Pauly*, 170, U. S., 133, with respect to the representations of the president not being within the scope of his duties, makes it necessary to point out the distinction between that case and the case at bar.

In that case it was ruled that the act of the president, in certifying to the integrity, efficiency, and fidelity of the cashier, was not the act of the Bank, for two reasons. (1) It was no part of the duties of the president, and therefore he is not presumed to have disclosed to the Bank what he had done. (2) He and the cashier were confederates in the dishonesty of the cashier, for the purpose of defrauding the Bank, and hence is not presumed to have notified the Bank of what he had done. In that case the bond did not refer to the statement of the president, it did not appear that the Bank procured the bond, and it was not shown that the Bank was aware of representations made by the president. In the case at bar the facts are wholly different. There is no contention in this case that either the president or cashier were the confederates of the bonded employe.

The cashier's bond refers specifically and accurately to the representations of the president; they are made a part of the bond,

and it is recited that the statements are made on behalf of the Bank. The language of the bond is:

> "Now, therefore, this bond witnesseth, that the said employe, for and on his own behalf, and the said Company, fully relying on the truth of the statement and declaration contained in a certain document distinguished as Employer's Guarantee Proposal No. 154,806, dated the 10th day of January, 1893, and signed 'Lewis T. Baxter, President,' *on behalf of the said employer*, and lodged with the said Company at its office in Montreal. . . . do hereby . . . covenant with the said employer to reimburse unto the said employer."[33]

The teller's bond was not renewed until the *Bank* complied with the conditions imposed by the Company, which was thus stated to the *Bank:*

> "It is necessary before the bond can be renewed that you obtain the certificate on the back hereof by your president or cashier, and on its return with remittance of the premium, the renewal can be immediately effected."[34]

The premium for each bond was paid by the Bank, and it was so represented to the Company in each instance before the bonds were granted. In this case the Bank procured each bond, and had knowledge that the representations had been made for it by its proper officer. As long as the bonded employe was teller, these representations were made by the cashier. When he was elected cashier, the representations concerning him were necessarily made by the president.

As to the teller's bond, the *Bank* desired a renewal, and the Company declined to grant a renewal *until* the *Bank* should certify the result of the examinations made concerning the employe's books and accounts, and thereupon the Bank did make the representations through its cashier.

As to the cashier's bond, the contract made the statements of the president a part of the consideration, and stated that the representations of the president were made on *behalf of the Bank.*

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[33] Trans., p. 6.

[34] Trans., pp. 88, 89.

In the *Pauly* case the Court says:

> The presumption that the agent informed the principal of that which his duty and the interests of his principal required him to communicate does not arise where the agent acts or makes declarations not in execution of any duty that he owes to the principal, nor within any authority possessed by him, but to subserve simply his own personal ends, or to commit some fraud against the principal. In such cases the principal is not bound by the acts or declarations of the agent *unless* it be proved that he had at the time actual notice of them, or having received notice of them, failed to disavow what was assumed to be said and done in his behalf.

In this case, if the president exceeded his authority, and if his representations were beyond the scope of his duties, still the Bank had actual knowledge of his acts, and did not disavow what was assumed to be said and done on its behalf.

The language of the bonds in this case show clearly dealings between the Bank and the Company for the issuance of the bonds, and they are, in fact contracts resulting from negotiations between the Bank and Company, and in which contracts the employe joins.

In the case at bar it is shown that the *Bank*, and not the employe, procured the suretyship bonds. The negotiation for them was between the Bank and the Company. This Court said in the *Pauly* case that these suretyship contracts are insurance contracts. If the Bank procures insurance upon its banking house against loss by fire, storm, or other contingency, it would certainly be within the scope of the officer's duties to make representations with respect to pertinent inquiries concerning the building. And if the Bank procures a contract of insurance against loss resulting from the fraudulent acts of its employe, it is equally within the scope of the officers' duties to answer pertinent inquiries concerning the Bank's affairs and the employe. The Bank entered into the contracts with the Company, and representations by its officers to the Company, which induced the making of the contracts, are clearly binding upon the Bank.

It is, therefore, confidently asserted that the question of the Bank's responsibility for the representations of its cashier and president, in procuring these contracts of indemnity, can not be the subject of dispute.

III.

SPECULATION.

The teller's bond was breached by the Bank in not reporting the speculation and disreputable habits of the bonded employe: and the cashier's bond was procured by a material misrepresentation as to his habits and associations.

This question of speculation is common to each bond, but applies in a somewhat different form. The teller's bond required immediate notice to the Company of the "employe being engaged in speculation or gambling, or indulging in any disreputable or unlawful habits or pursuits." The Bank procured the issuance of the cashier's bond by representing that it had not heard of and had not known of "anything unfavorable as to the habits or associations, past or present, of the employe." In the summer of 1892, during the currency of the teller's bond, and preceding the issuance of the cashier's bond in January, 1893, the Bank was told that the employe was speculating, and was a part owner in a "bucket shop." This information was confirmed to the Bank by the admissions of the employe, and from other sources. The employe was told by a director and member of the finance committee of the Bank that "he ought to quit that or quit the Bank." The president of the Bank knew that the employe was afflicted with the fever of speculation, and still retained him in the employ of the Bank, without any investigation and without notice of the facts to the Company, and induced it to issue the cashier's bond by withholding this information.

The opinion of the Court of Appeals thus states the facts:

> It is evidence that information came to the president and directors of the Bank, through their cashier, that Schardt was a partner in what was called a "bucket shop," an agency for promoting speculation in small amounts upon the fluctuations of stocks, grain, cotton, and other commodities in which speculative gambling is done, and that he himself was speculating. When charged with this, Schardt admitted that he had taken an interest in such a partnership, but that he had sold out. He called his former partners to confirm his statement in this regard. He also admitted, according to one of the witnesses, at another time, that he had speculated to some extent, but asserted that he had always made gains and had seen the error of his ways and had stopped. Subsequently the cashier received

an anonymous letter stating that Schardt was still speculating. He informed the president of the Bank. Schardt said it was a lie and no more attention was paid to it. All this occurred prior to the time when the president signed the guarantee proposal for the cashier's bond referred to. As a matter of fact, Schardt was speculating all the time, and lost the $100,000 he had stolen in gambling in futures.

The Circuit Judge thinks these facts, "when brought to the attention of the Bank officials, were a past event, and *apparently in itself unimportant.*" The Court of Appeals had an "impression that this defense rests on circumstances *comparatively inconsequential.*" The Court further says: "There is no proof that Schardt ever confessed to speculation or gambling, except that of Sykes, who is somewhat discredited because he has a litigation with the Bank and an apparent animosity toward it." Eatherly, a director, and member of the finance committee of the Bank, interested financially with the Bank in this litigation, and called to testify for the Bank, says: "Subsequent to that, I went to Mr. Schardt's house to see him, having heard *again* that he was speculating. I told him what I had heard, and he said it was not so, that he did not own any stocks at all. I told him that if he was he ought to quit that, or quit the Bank, *and he said that he had sold everything he had.*"[35]

It has been argued that Eatherly has stated that all this occurred just prior to the resignation of Judge Woodard as a director in this Bank, which occurred in February, 1893. This, however, is not correct. Mr. Eatherly states that he *again* heard that Schardt was speculating, and that *this* was just prior to the resignation of Judge Woodard in February, 1893.[36]

The statements of Sykes were not disputed, although he gave the names of all the parties, including the president of the Bank, who was not called to contradict Sykes.

Nor is it true, as stated by the Court of Appeals, that Sykes *thereafter* recommended him to the Company for a renewal of the teller's bond, or to the Bank as a suitable person to be his successor. The last renewal of the teller's bond was in January preceding; and Sykes merely stated, in reply to an inquiry, that

[35] Trans., pp. 51, 52.
[36] Trans., p. 52.

Schardt had the *ability* to perform the duties of cashier. Nothing was asked or said with respect to his character.[37]

All these facts concerning the speculation of the employe were developed by the company. The able counsel for the Bank deemed it best for the Bank to wholly refrain from either introducing other witnesses to contradict what had been developed, or even to test the accuracy of what these witnesses stated. This resulted from no lack of interest in the question or want of ability. The name of the counsel representing the Bank is sufficient evidence of this fact. He, no doubt, was fully impressed with the idea that the least said was the best for his client, and that any effort to destroy the force of what the Company had developed could but make it stronger.

When this case was before this Court on the former hearing, the effort was made by counsel for the Bank to show that it was really not so serious as was insisted by the Company. It was argued as if the real truth of the matter was far less in importance than the record disclosed. That if the importance of the question had been observed, while the testimony was being taken, *other* facts might have been developed to show how this was. That contention can no longer be relied upon. When the cause was remanded, the Company sought to reopen the case for additional evidence of this speculation and the knowledge of the Bank's officials. The Bank objected, and its objection was sustained by the Court. The Company sought to show that the chairman of the executive committee of the Bank had knowledge of this speculation, and that the president knew more of the matter than was contained in the record. But the Bank *resisted any* effort to develop the facts. And for these reasons it is insisted that the importance of this question being overlooked by the Bank until the record was closed, can no longer be relied upon.

While each of the Courts deciding this case held this information unimportant, *this* Court and all others have not so regarded such information.

PRESTON v. PRATHER.

137 U. S., 604.

This case involved the liability of a bank for the loss of bonds

[37] Dep. Porter, cross-q. 7, Trans., p. 67.

abstracted by its assistant cashier. The bank was held guilty of gross negligence, and liable as a gratuitous bailee, under the facts thus stated in the opinion of the Court:

It was shown that, about a year before the assistant cashier absconded, the defendant, Kean, who was the chief officer of the banking institution, was informed that there was some one in the bank speculating on the Board of Trade at Chicago. Thereupon Kean made a quiet investigation, and the facts discovered by him pointed to Ker, whom he accused of speculating. Ker replied that he had made a *few transactions*, but was doing nothing then, and did not propose to do anything more, and that he was then about a thousand dollars ahead, all told. It was not known that Ker had any other property besides his salary. His position as assistant cashier gave him access to the funds as well as the securities of the bank, and he was afterwards kept in his position without any effort being made on the part of the defendants to verify the truth of his statement, or whether he had attempted to appropriate to his own use the property of others.

Again, about two months before Ker absconded, one of the defendants, residing at Detroit, received an anonymous communication stating that some one connected with the bank in Chicago was speculating on the Board of Trade. He thereupon wrote to the bank, calling attention to the reported speculation of some of its employes, and suggesting inquiry and a careful examination of its securities of all kinds. On receipt of this communication, Kean told Ker what he had heard, and asked if he had again been speculating on the Board of Trade. Ker replied that he had made some deals for friends in Canada, but the transactions were ended. The defendants then entered upon an examination of their books and securities, but made no effort to ascertain whether the special deposits had been disturbed. Upon the subject, the Court below, in giving its decision (29 *Fed. Rep.*, 498), after observing that the defendants knew that Ker had been engaged in business which was hazardous, and that his means were scant, and, after commenting upon the demoralizing effect of speculating in stocks and grain, as seen in the numerous peculations, embezzlements, forgeries, and thefts, plainly traceable to that cause, and the free access by Ker to valuable securities, which were transferable by delivery, easily abstracted and converted, and yet he being allowed to retain his position without any effort to see that he had not converted to his own use the property of others, *or that his statements were correct*, held that it was gross negligence in the defendants not to discharge him or place him in some position of less responsibility. In this conclusion we fully concur.

The exact language of Judge Gresham, thus approved by the Court, is:

It is immaterial, however, whether the defendants were bailees with or without reward, as in either case they are liable for the value of the bonds, the loss having resulted from their gross negligence. The defend-

ants knew that Ker had been engaged in business which was hazardous, and that his means were scant. The demoralizing effect of speculating in stocks and grain—more properly speaking, gambling on the rise and fall of the price of stocks and grain—is seen in the numerous peculations, embezzlements, forgeries, and thefts plainly traceable to that cause. Ker had free access to valuable securities, which were transferable by delivery, easily abstracted and converted; and yet he was allowed to retain his position without any effort to see that he had not converted to his own use the property of others, or that his statements were correct. A prompt examination, after his first admission that he had been speculating, would have doubtless shown that even then some of the plaintiffs' bonds had been exchanged for others, if, indeed, they had not been stolen. Ker's position was one of trust and great importance. *His own admission showed that he was not trustworthy for such employment*, and it was *gross negligence* in the defendants not to discharge him, or place him in some position of less responsibility.

Prather v. Kean, 29 Fed. Rep., 502.

In *Scott* v. *National Bank of Chester Valley*, 72 Pa., 479, the fact that the employe was suffered to remain in the employ of the bank, after it was known that he had dealt "*once or twice*" in stocks, called forth the following language by the Court:

No officer in a bank, engaged in stock gambling, can be safely trusted, and the evidence of this is found in the numerous defaulters whose peculations have been discovered to be directly traceable to this species of gambling. A cashier, treasurer, or other officer having the custody of funds, thinks he sees a desirable speculation, and takes the funds of his institution, hoping to return them instantly, but he fails in his venture, or success tempts him on, and he ventures again to retrieve his loss or increase his gain—and again and again he ventures. Thus the first step, often taken without criminal intent, is the fatal step which ends in ruin to himself and to those whose confidence he has betrayed. Hence, *any* evidence of stock gambling or dangerous outside operations, should be visited with *immediate dismissal*.

This language was quoted with approval by this Court, in *Preston* v. *Prather* (*ibid*), and all these cases are referred to with approval by the Court of Appeals in Illinois.

Gray v. Merriam, 148 Ill., 179.

See also—

Merchants' Nat. Bank v. Guilmartin, 93 Ga., 503.

This subject of speculation has received the consideration of the Legislature and the Courts of Tennessee.

By Chapter 251, Acts of 1883, it is enacted:

That hereafter any sale, contract, or agreement for the sale of bonds, stock, grain, cotton, or other produce, property, commodity, article, or thing for future delivery, when either of the contracting parties, buyer or seller, is dealing simply for the margin, or on the prospective rise or fall in the price of the article or thing sold, and when either of said contracting parties have no intention or purpose of making actual delivery or receiving the property or thing in species, shall be deemed, and is hereby declared, gambling.

Since 1883, a heavy license tax has been imposed upon such business, and in 1895 the tax was made $50,000 per annum.

In *Palmer & Cartwright* v. *State*, 88 Tenn., 553 (1889), it is held that the license tax does not legalize or protect the business from the criminal laws of the State, citing License Tax Cases, 5 Wall, 462, but is an additional burden upon the business.

In *McGrew* v. *City Produce Exchange*, 85 Tenn., 578, the Court, in construing the Act of 1883, above quoted, said:

This Act was intended to make it unlawful if either party had no intention of effectuating a real purchase or sale. It was designed to suppress the evil of dealing in futures, and to limit such operations to *bona fide* sales and purchases by those who wished to sell to those who intended to buy. In making the seller responsible for the intent of the buyer, and the buyer responsible for the intent of the seller, it intended to suppress gambling by confining the business of buying and selling for future delivery in such limits as would practically preclude the possibility of it. The *bona fide* dealer can still operate, but he can not do so upon any terms which do not protect the community against the pernicious and ruinous speculation in the rise and fall of prices.

ALLEN v. DUNHAM.

92 Tenn., 257.

In this case it appears from the opinion of the Court that Allen was teller in a Nashville bank, where the defendant in error was located. In May, 1890, he purchased, among other things, $90,000 of securities in one of these "bucket shop" concerns, but in the name of and through his outside friend, Dismukes. He became a defaulter and transferred his claim to recover money lost at gambling in this "bucket shop" to the bank, to secure his embezzlement. The bank thereupon sued the "bucket shop," and in the opinion of the Supreme Court, delivered at the December

Term, 1892, after quoting what is above copied from the opinion in *McGrew* v. *City Produce Exchange*, it is said:

> We add to what has already been so well said, that there is no evil more demoralizing and pernicious in its tendencies and consequences than the spirit of reckless speculation which pervades so largely all sections of our country, and all classes of society. It inevitably leads to peculation, embezzlement, and other crimes. It crushes legitimate business, and creates an unhealthy excitement, which brings ruin as its result. . . . . .
>
> Now, what facts are developed in this case? We have a young man occupying an honorable and responsible position as bank teller, intrusted with the funds of the bank and its customers. Possessed with an unnatural desire to grow rich suddenly, he finds these defendants offering him a field which he can enter for a comparatively small sum, and thereby become the ostensible owner and controller of stocks to an almost unlimited amount, subject to daily fluctuations, which, if favorable to him, would in one day realize for him more than he could earn in a year of hard labor at his legitimate work. Is it any marvel that he is induced to enter the inviting field?

It thus appears that at the time the defendant in error was receiving confessions from *its* teller that he was speculating and running a "bucket shop," and declining to notice anonymous communications warning them of his conduct in this respect, the example of a blighted life and a ruined institution, all caused by the speculation of a teller, was being rehearsed in the courts in the same city, and *yet* the Courts trying this case have said that all this information was "in itself unimportant," and "comparatively inconsequential;" and the president of this Bank, with this startling example of the ruin and disgrace which inevitably follows in the wake of an employe handling trust funds and speculating, not only declines to heed the warnings of anonymous letters following the confession of the employe, but makes no investigation of the matter, gives no warning to the surety as required in the bond, and then represents that he has *never heard of anything unfavorable, past or present*, of this speculator and "bucket shop" dealer. He is not called to explain or deny any of these facts. He is not called to testify as to his honesty or good faith in this matter, and *yet each* of the Courts trying this case has apparently attributed to him *both* honesty *and* good faith. No bank president, standing in the shadow of facts disclosed in the case of *Allen* v. *Dunham* (*ibid*), having knowledge of facts disclosed in this record, can be credited with having acted honestly or fairly

with the surety Company in not reporting the speculation, as required in the teller's bond, and in representing such an employe worthy of confidence.

In the case at bar the confessed acts of the bonded employe were far more serious than those of the employes in the above cited cases. Here the employe, without means, upon a salary of $100 per month, with his entire business career in the Bank, not only admitted having "speculated to some extent," but that he had, while teller of the Bank, become part owner of a "bucket shop," which is not merely acting as agent for others, but is the taking of all bets tendered by the public. *Allen* v. *Dunham* (*ibid*). It is the most demoralizing and the most vicious form of all speculation. And if it be gross negligence and want of good faith in a bank not to discharge an employe confessing to have made a "few deals," what will be said of the action of a bank retaining in its service an employe confessing to having speculated to some extent, and to having been part owner of a "bucket shop"? What process of reasoning can make it good faith upon the part of the president of the bank, possessed of such information, who represents to a proposed surety, that he has never heard or known of *anything* unfavorable concerning such an employe? How can good faith be accorded to the managing officers of a bank, who fail to report such knowledge of speculation and indulgence in such a disreputable pursuit as speculation and part ownership in a "bucket shop," when the bank is under contractual obligation to report such conduct to the surety of such an employe? How can any Court deem such information "apparently in itself unimportant"?

The Circuit Judge thinks that the *extent* of the speculation was not sufficient to require notice to the Company, and the Court of Appeals rather discredits the direct and positive evidence of Sykes, a witness unimpeached, uncontradicted, and sustained, if not by direct and positive testimony, certainly by circumstances of the greatest weight and importance. Eatherly, a director, and a member of the finance committee of the Bank, a witness offered by the Bank and interested in this litigation, says that Schardt told him in the presence of Baxter, the president of the Bank, that he had been part owner in a "bucket shop"; and on another occasion admitted that he had been speculating. It is not unreason-

able that Sykes should have received the same information, aside from his positive and uncontradicted testimony.

Both the Courts trying this case refer to the failure of the local agent of the Company to learn of the speculation of Schardt. What can be said of the action of the Bank in failing to discover the truth, having the knowledge of facts that made an investigation imperative, if neglect be attributable to the agent of the Company in not discovering the truth, who had no suspicion of the matter? The word of the employe was accepted by the Bank for the truth of the statement that he had ceased to speculate, without any independent investigation being made. The Company was deprived of the opportunity of making any investigation because of the failure of the Bank to give notice to the Company, as required by the bond of the information had.

With respect to the cashier's bond, the Company certainly had the right to know of this speculation and "bucket shop" dealing, when the president of the Bank was asked about the employe. If the confession of the employe to having made a "few deals" made it the imperative duty of the bank to discharge him; if it was gross negligence and bad faith in the bank to have retained him in a position of trust, how much the greater was the duty to discharge, and the bad faith in retaining him, when, in addition to the confession of a "few deals," the employe confessed to having had an ownership in a "bucket shop"? Was not this information unfavorable? Was it not discrediting? Can *any* bank president truthfully represent "to the best of his knowledge and belief," that he has not known of or heard of anything unfavorable of such an employe?

It was a breach of the written contract voluntarily entered into between the Bank and the Company in the case of the teller's bond, and a material misrepresentation in procuring the cashier's bond.

Beyond and above any amount of speculation as to why the Bank acted as it did, the fact remains that the Company desired to know of any speculation upon the part of the bonded employe, and hence stipulated for it; and the Bank breached the stipulation in not imparting the information it had.

As to the statement of the president that he had never heard of anything unfavorable as to the employe, which statement in-

duced the issuance of the cashier's bond, it is certain that he *had* heard of matters during the preceding year, which rendered the employe unworthy of confidence and demanded his immediate discharge. It is wholly immaterial why the president did not impart this information. He did, in fact, withhold the information which he had and was requested to give, and he is not called as a witness to explain his conduct, nor is any reason offered for not doing so.

Both the letter and spirit of the suretyship contracts were violated in this question of speculation and "bucket shop" dealings. The condition of the teller's bond was a reasonable one, having for its purpose the protection of the Bank as well as the Company. To construe it into meaning such an improbable thing as notice only when the employe is apprehended in the very act of making a speculative deal, would not be in keeping with the ordinary meaning of the words used, nor the purpose had in view by the Bank and the Company in the making of this condition of the contract.

And the representation of the Bank's president that he had not heard of anything unfavorable as to the employe, can not be explained away upon any possible theory consistent with veracity, good faith, or a fair understanding. If, as this Court has said, it be *bad faith* to merely retain an employe in the service of the bank who has been speculating "to some extent"—"made a few deals," how can it be called *good faith* in one knowing such facts, and the additional fact of ownership in a "bucket shop," to represent that he knows nothing, past or present, unfavorable concerning the employe? Nor should the Court be called upon to invent an escape from the plain imputation of bad faith for Baxter, who, although accessible, is not called to explain for himself. If the Bank's counsel did not attempt to *explain* away this evidence with other witnesses, why should the Court endeavor to *reason* it away?

The representation of Baxter was in his official capacity, and for the benefit of the Bank in the scope of his duties, and is, therefore, binding upon the Bank. The representation was material, and was false. The contract obtained under it can not be enforced. If the statements of the president were not authorized by the Bank, and were not in the apparent scope of his authority, the

Bank adopted and ratified his act. The bond recited that the Company relied upon the statement of the president and specially referred to it as a part of the contract, and recited that the bond should be void upon the misstatement of a material fact.

It is universally held that when an employer knows the employe has been guilty of dishonest conduct, and conceals the information from the contemplated surety, the bond is void, whether inquiry be made by the intended surety or not.

Smith v. Bank of Scotland, 1 Dow., 294.
Phillips v. Foxall, L. R., 7 Q. B., 666.
Franklin Bank v. Cooper, 36 Me., 179.
Franklin Bank v. Stevens, 39 Me., 532.
Wayne v. National Bank, 52 Pa., 343.
Bostwick v. Van Voorhis, 91 N. Y., 353.
Clark v. Mfg. Ins. Co., 8 How., 335.

The reason assigned in all these cases is, that it is so little to be expected that an employer would continue in service such an employe, that it amounts to holding him out as a person of trust, and that this amounts to a fraud. If there be any unusual matter affecting the risk which the insured knows and the insurer may be ignorant of, then the information must be volunteered, even though not inquired about.

It is not necessary to go to that extent in this case, because here the direct inquiry was made by the Company,[28] and the answer made a part of the contract.[29] Hence, if the Bank concealed information or misrepresented what, if known, would have materially affected the risk, the contract is avoided. In this case the Bank both concealed and misrepresented the information it had touching Schardt's speculation and interest in a gambling concern. And the Courts hold that evidence of stock gambling, such as the Bank had in this case, rendered the employe wholly unworthy of trust, and *demanded his immediate dismissal.*

In contrast with the action of the Bank in not reporting the speculation to the Company, and in representing that nothing unfavorable, past or present, was known, is the action of the Company when it did receive notice of speculation, and the action of the Bank when the bond was canceled by the Company. Imme-

[28] Stipulation, q. 4, Trans., p. 90.
[29] Cashier's bond, Trans., p. 5.

diately upon learning that the employe had been speculating, the Company canceled the bond.[40] So soon as the Company did this, and notified the Bank why it did so, the Bank caused an examination of the books and accounts to be made.[41] The examination was scarcely begun when the stupendous frauds appearing on the books were discovered, and the wisdom of the rule of law announced by this Court verified. The examination began with a trial balance from the individual ledger compared with the general ledger.

No explanation has been offered to justify or excuse the breach of the condition in the teller's bond, or the misrepresentation of the Bank in procuring the cashier's bond.

No recovery can be had under either bond.

IV.

MISREPRESENTATION OF CONDITION OF BANK BOOKS.

Each bond was procured by representing to the Company that the books and accounts of the employe had been examined and found correct to January, 1892, when the teller's bond was renewed, and to January, 1893, when the cashier's bond was issued. These representations were material, and false.

When the teller's bond expired in January, 1892, the Bank applied for a renewal for another year. The Company replied that the bond could not be renewed until the Bank stated that the books and accounts of the employe had been examined and *verified*. Thereupon the Bank, through its cashier, made the representation that this had been done by the finance committee of the Bank to December 31, 1891. The bond was then renewed.

When application was made for the cashier's bond in January, 1893, this Bank represented to the Company that the books and accounts of the employe had been examined to December 31, 1892, and found correct. The cashier's bond was then issued.

On December 31, 1891, the *books of the bank* showed the employe was a defaulter for the sum of $23,365.44, of which amount

[40] Dep. Cooley, q. 3, Trans., p. 82.

[41] Dep. McEwen, cross-q. 1, Trans., p. 30.

$19,600 represented understated liabilities, and $3,765.44 abstractions from the notes in a bank having only $50,000 capital.

It must be conceded that there was no *verification.* The only member of the committee testifying, admits that *Schardt's word was accepted* for the correctness of the amount appearing upon his books to be due depositors, and *admits there was a way* to *verify* the statement.[42] And, in this case, the comparison could and should have been made. The Bank, knowing that this verification *could* have been made, and that it was not made, *knew* that its statement to the Company that the books and accounts had been examined and *verified,* was false.

The statement was also false because there was no *examination.* The *assets* were no doubt examined, but the *books* were not. The assets were examined with a view to the *solvency* of the notes and collaterals, but the *amount* of the assets and the *amount* of liabilities *could not* have been examined.

It no doubt will be conceded that to open each book, glance at a page on each, and close them up, would not be an examination of such books; and scarcely more than this was done, because there was no comparison of ledger balances, and no correct footing of the notes in the Bank.

The representation was that the books and accounts *had been examined and verified, not* that the employe was supposed to be honest and correct in his accounts; *not* that the Bank believed that an examination would disclose no shortage; *not* that the Bank had sufficient confidence in the integrity of Schardt to suppose an examination unnecessary. Whatever idea may have been entertained by the Bank with respect to the correctness of its own affairs, it is nevertheless true that the Bank, without qualification, represented that it had done a particular thing when it had not done so.

The first thing that would suggest itself to an examining committee would be to compare ledger balances, especially as this was the only means of ascertaining even approximately, whether the books were correct; and it is equally plain that a correct comparison should be made between the aggregate amount of notes in the Bank and the amount called for by the books of the employe intrusted with the collection of the notes. It can not be that a bank

[42] Dep. Eatherly, cross-q. 60, 61, and 67, Trans., p. 48.

committee supposed that an examination of the books of the Bank consisted in asking the employe how much assets he should have, and then counting the assets to see that they agreed with the amount the employe said he should have; and yet it appears that this Bank scarcely did this, because the notes of the Bank were less than the amount the books of Schardt called for. No doubt some of the finance committee did have meetings as represented. No doubt they examined the notes, stocks, bonds, etc., held by the Bank, but this was done with a view of determining the solvency and value of the securities. The committee, supposing Schardt to be honest, did not deem an examination of his books necessary. The Bank *may* have supposed the representation that the books had been examined and verified a mere form; but it was not a form; it was a question of fact, and was false.

One of the committee says they looked to the cashier, who was an expert bookkeeper, to see that the books of the Bank were kept correctly.[43] The cashier, Sykes, says he never had anything to do with the examination of the books.[44] No member of the committee has testified that he did not know how such examinations could have been made, and no one of them had the courage to say he was ignorant of what should have been done. The only one who does testify concerning what was done says they had Schardt's word for the correctness of the false account.[45]

On December 31, 1892, the *books of the Bank* showed the employe was a defaulter for the sum of $73,715.44, of which amount $69,700 represented understated liabilities, and $4,015.44 abstractions from the notes in a bank having a capital of only $50,000.

When this purported examination was made in December, 1892, the Bank knew the employe had been speculating "to some extent" and had been part owner of a "bucket shop." Mr. Eatherly, the chairman of this committee, had the confession of Schardt that he had been speculating and running a "bucket shop," and if *any* information would require a careful examination, this would. Whatever may be said of the former examinations, this knowledge made a careful examination imperative.

When the teller's bond was renewed in January, 1892, the

[43] Dep. Jno. A. McEwen, qq. 4, 10, Trans., p. 76.
[44] Dep. Sykes, cross-qq. 5, 7, Trans., p. 66.
[45] Dep. Eatherly, cross-q. 6?, Trans., p. 48.

situation of the parties was this: The employe upon whom the bond was desired had occupied the position of teller in the Bank since 1888. The only means of knowing the fidelity with which he had handled the funds of the Bank was to make inquiry of the Bank. The officers and directors were assumed to be reasonably prudent men. If a reasonably prudent examination failed to disclose any default, the Company could afford to renew the bond. The inquiry was made, and answered by the Bank, and the bond renewed. Upon the other hand, the books of the Bank were out of balance $19,600. The notes in the Bank were less by $3,765.44 than called for by the books kept by the employe, who was also the custodian of the notes. The universal, and indeed the *only* way to examine the books of the Bank was to compare the balance on the books kept by Schardt with the balance on the books kept by the individual bookkeeper. This comparison would have disclosed the shortage. The correct footing of the notes in the Bank compared with the amount called for on the books kept by the bonded employe would have disclosed the shortage. It is customary in all banks to compare trial balances every thirty days. It was customary to do this in this Bank until 1890, but after that it was never done. At any time within three years prior to the failure of this Bank, a comparison of trial balances would have detected this shortage of the bonded employe. The cashier of the Bank during all this time was an expert accountant and a member of the finance committee making the examinations.[46]

When the cashier's bond was issued in January, 1893, the situation of the contracting parties was this: Schardt had been in the Bank from 1887 to January, 1893. The only information obtainable with respect to his business habits and integrity was through the Bank. He had just been elected cashier, and the Bank desired a bond in the sum of $20,000. The Company desired certain information before assuming the risk . It applied to the Bank. Within the keeping of the Bank was his business career of the six preceding years. The official report showed the Bank to have been well managed, so well, in fact, that its accumulated surplus exceeded the half of its entire capital. It was, therefore, not negligent for the Company to assume that its officers were reasonably skillful bank officials. If Schardt had properly and honestly han-

[46] Deposition of McEwen, questions 6 and 10, Trans., p. 76.

dled the funds of the Bank for more than five years, the presumption would be that he was an honest employe and worthy of the risk to be assumed by the Company. If irregularities in his accounts had existed to any appreciable extent, the Bank would have detected it, assuming the books and accounts had been examined. If he had been guilty of default or misconduct, the Bank would have observed it in the course of so long a period.

The Company was unwilling to issue this bond without making such inquiry. Therefore, knowing that such information could only be obtained from the Bank, it made the inquiry as to whether the books and accounts had been examined, and, if so, whether they were found correct. This statement of the Bank in reply to the inquiry was expressly made a part of the contract.

No explanation has been offered by the Bank to explain why these examinations were not prudently made. The record does not present any fact or circumstance to show good faith or prudent conduct upon the part of the Bank officials.

It is quite true that several months were consumed by the expert accountants in ascertaining the *exact amount* of the shortage, but only a *few hours'* examination of the *bank books* were necessary to discover that there was a *very large default.*[47]

It is also true that there were certain *items* of the default which required the calling in of all pass books and a very searching investigation to ascertain the *exact* amount of the Bank's loss. But all these items may be eliminated in the discussion of this case, since they nearly all occurred after January 1, 1893. Complant is directed to the failure of the Bank officers in detecting the enormous losses *apparent upon the books of the Bank;* and the failure to discover *some part* of the many errors in the Bank *books,* which could have been discovered with the *slightest* examination. Whatever was shown upon the face of the Bank books, revealing the shortage, should have been known, and why it was not known has received no satisfactory answer, either in the record or in the argument of counsel. And this failure becomes the more startling when the depositions of the Bank officers are considered.

Eatherly seems to have been the head and front of all examining committees of the Bank. He undertakes to show how very

[47] Dep. McEwen, cross-q. 5, p. 31.

careful and scrutinizing he was at all times in making examinations. He would have the Court understand that he was careful and even exacting, and he is convincing in his efforts to show that he not only knew just *what* should be done, but just *how* to do it. And yet the astonishing fact remains that the shortage was *not* discovered, *although* the *simplest* and *only possible* examination could not fail to have disclosed the loss.

These officers do not plead ignorance and good faith, but knowledge and the performance of duty. They do not ask to be excused upon a plea of failure to discover the loss because they did not know what they *should* do, and therefore did all they *knew how*, but they show that they knew all about bank examinations and insist that they did in fact make thorough investigations, and yet the failure to discover the loss remains a mystery. There is eliminated from the discussion all the errors not discoverable except by calling in pass books, failure to enter deposits upon the books, failure to enter money collected, and failure to enter notes discounted, yet after eliminating all these, there remains a shortage, December 31, 1891, when the examination was made to procure the last renewal of the teller's bond, of $23,365.44; and on December 31, 1892, when the examination was made upon which the cashier's bond was procured, there was a shortage of $73,715.44. *All this shortage appeared upon the books of the Bank.*

The total shortage, as finally fixed, was on January 1, 1892, $28,167.34. Of this amount $23,365.44 was apparent upon the bank books, consisting of $19,600 less deposits on the books kept by Schardt than was shown on the individual ledger, and $3,765.44 less notes owned by the Bank than the amount called for on the Bank books.

In the same manner, the total shortage, as finally fixed, was on January 1, 1893, $78,817.24. Of this amount $73,715.44 was apparent upon the Bank books, consisting of $69,700 less deposits on the books kept by Schardt than was shown on the individual ledger, and $4,015.44 less notes owned by the Bank than the amount called for on the Bank books.[48]

Now, *after* January 1, 1893, Schardt did embezzle the funds of the Bank in almost every imaginable way, but all this is beside

[48] Trans., p. 35, ques. 43.

the question, since the last examination, affecting the rights of the Company, was made December 31, 1892, when the cashier's bond was procured, and on December 31, 1891, when the last renewal of the teller's bond was procured.

The effort is made to show how very difficult it would have been to compare ledger balances, which comparison at any time in three years preceding the failure of the Bank would have disclosed the shortage. Witnesses are introduced to show what a long time it would have taken to procure a trial balance from the individual ledgers for comparison with the general ledger balance, which would have revealed the default. One witness says it would have taken twelve hours, another twenty-four to thirty-six, yet the bookkeeper who *did* take off these balances before they were discontinued in the latter part of 1890, says that he *always* did so between the close of business one day and the opening of business the next, and that this *sometimes* necessitated his doing part of the work at night.[49]

When this teller's bond was renewed in January, 1892, it was, in legal effect, the making of a new contract of insurance.

Biddle on Insurance, Sec. 341.
May on Insurance, Sec. 70a.

This Court has thus defined the duty of bank directors:

We hold that directors must exercise ordinary care and prudence in the administration of the affairs of a bank, and that this includes something more than officiating as figureheads. They are entitled under the law, to commit the banking business, as defined, to their duly authorized officers, but this does not absolve them from the duty of reasonable supervision.

Briggs v. Spaulding, 141 U. S., 132.

The Supreme Court of Tennessee has thus stated their duty:

Directors, by assuming office, agree to give as much of their time and attention to the duties assumed as the proper care of the interests intrusted to them may require. If they are inattentive to these duties, if they neglect to attend meetings of the board, if they turn over the management of the business of the company to the exclusive control of other agents, thus abdicating their control, then they are guilty of gross negligence with respect to their ministerial duties; and if loss results to the corporation by breaches of trust or acts of negligence committed by those left in control,

[49] Dep. Boench, q. 13, p. 64.

which by due care and attention on their part could have been avoided, they will be responsible to the corporation. The diligence required from them has been defined as that exercised by prudent men about their own affairs, being that degree of diligence characterized as ordinary. If a less degree of diligence is exercised, the negligence is gross, and for losses consequent he is liable.

Wallace v. Lincoln Savings Bank, 5 Pickle, 652.

The Company had the right to assume that the directors of this Bank had done what the law required of them, and that they had at least exercised ordinary diligence in the conduct of the Bank.

The duty of the paid officers of the Bank must be greater than this. And when the books of the Bank clearly show a large default, easily discoverable by the exercise of the most ordinary examination, the failure of the paid officers to discover the default is more than mere neglect. The cashier was an expert accountant.[50] The *only* way the examinations could *possibly have been made* would have shown the default.

The information sought by the Company, and the representations made by the Bank with respect to these examinations, were matters peculiarly and exclusively within the knowledge of the Bank. The Company had the right to rely upon its representations, and for that reason the duty of knowing and telling the truth was imperative.

Pom. Eq. Jur., Sec. 888.
Morse on Banks, Sec. 21.
Biddle on Insurance, Sec. 462.
Cooley on Torts, Sec. 499.
Trimble v. Reid, 31 S. W. Rep., 861 (Ky.)
Franklin Bank v. Cooper, 36 Me., 179, 197.
Graves v. Lebanon National Bank, 10 Bush., 23.

The last case cited is somewhat similar to the one at bar, except that the surety in that case was an individual; but the law of the case must be the same, whether the surety be an individual or an insurance company. Whatever difference there may be between these two classes of sureties, it is not with respect to the principle laid down in that case. There may be a difference with respect to the duties and obligations imposed by the terms of the

[50] Dep. McEwen, q. 4, Trans., p. 76.

contract where the sureties are individuals, which may be governed by somewhat different principles from cases in which an insurance company is the surety. In the latter class of cases the courts may presume that all the conditions and duties to be performed by the beneficiary are embraced in the contract, while in the former cases the courts may be more liberal with respect to matters which release the sureties from their obligation. And in another respect, with individual sureties, the obligation may be more strictly construed that in cases where insurance companies become sureties, but *no* case can be found in which the rights of the sureties are in any respect different, whether they be individuals or insurance companies, with respect to the release of the sureties because of material misrepresentations. In the last case cited, the Court says:

> A fraud may be perpetrated as well by the assertion of facts that do not exist, ignorantly made by one whom the person acting upon the assertion has the right to suppose has used reasonable diligence to inform himself, as by concealing facts known to exist, which, in equity and good conscience, ought to be made known.
>
> We have, therefore, a case in which the directory of the bank held out to others as a trustworthy officer, a man who had been guilty of repeated embezzlements and frauds, all of which might have been discovered by the exercise of slight diligence.

This case was affirmed in *Deposit Bank* v. *Hearne,* 48 S. W. Rep. 160. (Ky., 1898.)

In the case at bar, the officers not only had in their employ an employe who has been guilty of repeated embezzlements, all of which might have been discovered by the exercise of slight diligence, but facts touching his conduct which imperatively required his immediate dismissal, and a most careful examination of his accounts. Yet no careful examination was made, but the statement to the proposed surety *was* made that the books and accounts *had* been examined and *had been found correct.* The slightest examination would have shown the default. Not one page of the books was correct, and the incorrectness was apparent upon each page. Neglect, in such case, is followed by all the consequences of bad faith. "If," in the language of *Knapp* v. *Bailey,* 79 Me. 195, "a party has knowledge of such facts as would lead a fair and prudent man, using ordinary caution, to make further inquiry, and he avoids the inquiry, he is chargeable with notice of the facts

which, by ordinary diligence, he would have ascertained. He has no right to shut his eyes against the light before him. He does a wrong in failing to heed the signs and signals seen by him. It may be well concluded that he is avoiding notice of that which he, in reality, believes or knows."

A statement recklessly made, without knowledge of its truth, is a false statement, knowingly made.

Cooper v. Schlisinger, 111 U. S., 148.
Nevada Bank v. Portland Bank, 59 Fed. Rep., 338.

In *Mouler* v. *Ins. Co.,* 111 U. S., 335, it is said:

> Looking into the application upon the faith of which the policy was issued and accepted, we find much justifying the conclusion that the company did not require the insured to do more, when applying for insurance, than observe the utmost good faith, and deal fairly and honestly with it in respect of all material facts about which inquiry is made, and as to which he has, or should be presumed to have, knowledge or information.

In the case at bar the Bank held out as trustworthy an employe who had been guilty of repeated embezzlement, all shown upon his books. The Bank represented that these books had been examined and found correct. The facts were exclusively within the keeping of the Bank, and its representation could not be verified elsewhere. This information was sought for the purpose of deciding upon the issuance of the bond, and the Bank was informed of this purpose.

These material misrepresentations prevent a recovery under either bond.

V.

SUPERVISION OF EMPLOYE AND INSPECTION OF BANK BOOKS.

The Bank failed to observe the conditions of the tellers' bond requiring an annual inspection or audit of the books and accounts; and to observe all due and customary supervision over the employe for the prevention of default.

These defenses apply alone to the teller's bond. The bond states:

> "The following provisions are also to be observed and binding as a part of this bond:
>
> "That the employer shall observe, or cause to be observed, all due and customary supervision over the said employe for the prevention of default.
>
> "That there shall be an inspection or audit of the accounts and books of the employe, on behalf of the employer, at least once in every twelve months from the date of this bond."

The condition with respect to supervision for the prevention of default is not thought by counsel for the Bank to refer to the books and accounts of the employe, but "supervision personally of the employe." The Court of Appeals construed the condition to refer to supervision of the Bank's affairs in connection with the duties of the employe.

If the condition of the bond refers personally to the employe, then there was a clear failure of the Bank to examine into the conduct of the employe when he admitted having speculated, and having been part owner in a "bucket shop," and also when additional information was received by anonymous letters that he was still speculating. If an examination had been made at this time, the statement of the employe that he had sold out and quit speculating would have been shown to be false, because he was, during all this time, speculating and embezzling the funds of the Bank.

The Court of Appeals, in construing this condition of the bond, uses this language:

> Much proof was taken to show what amount of supervision is ordinar-

ily and prudently taken by other banks, and generally in the banking business, to prevent default it being assumed that there was a contract here for that kind of supervision, or at least that which ordinary prudence in any business would require. Certainly these words may mean that, but not necessarily.

The contention of the Company is that the language used in the bond is unambiguous, and means just what it says; that is, all due and customary supervision, and the purpose of the condition is expressed in the words "for the prevention of default." In other words, the Company agreed to reimburse the Bank any loss resulting from the default of the employe, upon the condition that the Bank would exercise all due and customary supervision over the employe *for the prevention of default*. The condition is analogous to the language of fire insurance contracts prohibiting the storage of combustibles, requiring precautions against fire, and requirements looking to the protection of the property against fire. It is analogous to conditions in life policies looking to the preservation of good health.

What interest could the Company have in requiring examinations other than to prevent a default? And hasn't the Company the right to require supervision to prevent the default, if there be one, becoming larger by continued neglect, and thus by failing to detect the dishonest employe, enable him to continue his dishonest acts?

The condition was neither harsh nor hostile to the interests of the Bank. The temptation and opportunities were sought to be limited by requiring all due and customary supervision, so that the risk assumed by the Company would not be so great; and did not contemplate the cessation of the duty imposed by law upon the Bank to use all due and customary supervision over the employe to prevent losses by the stockholders and creditors of the Bank. Upon the contrary, the condition of the bond made it clear that the Company intended the Bank to fully understand that if all due and customary supervision for the prevention of default was not exercised, it would not be responsible to the Bank.

The Company did not undertake the unnecessary and uncalled for risk of protection to the Bank against losses occurring because of the lack of due and customary supervision by the officers of the Bank, but only the losses that might result *after* the exercise of this supervision. The indemnity was to protect the Bank against

loss that could not be prevented where the legal duty of the Bank officials was exercised. The Bank officers could not abandon their duty to exercise all due and customary supervision over the employe for the prevention of default, and the Company did not contract to assume such a risk. The contract was mutual, the Bank was to exercise due and customary supervision for the prevention of default, and the Company was to be responsible for any loss resulting *after* this supervision was exercised. If the condition of the bond does not mean this, it does not mean anything at all, and is mere surplusage. This construction is reasonable, and is clearly the intention of the contracting parties. If the Bank was bound under this condition of the bond to exercise all due and customary supervision over the employe for the prevention of default, the question of what is due and customary supervision only remains to be determined. The law has already determined what this is. Ordinary care and attention is the test even for directors, and much greater care and attention from the paid officers of the Bank. Citation of authorities is unnecessary for this proposition.

If, however, the condition of the bond does not refer to such supervision as the law requires, but refers to the supervision exercised in this Bank when the bond was obtained, or the supervision exercised by other banks generally,the result is the same. The facts show that neither the supervision exercised in this Bank when the bond was procured, nor the supervision exercised generally by other banks, nor the supervision required by law to be exercised, was, in fact, exercised by this Bank; and no ingenuity can suggest any plausible theory of what supervision was contracted for, which will show a compliance with this condition upon the part of the Bank. And an examination of the facts in the record will verify the statement that due and customary supervision, in whatever sense the words could have been used, was not, in fact, exercised by this Bank over the bonded employe.

The facts in the record show that up to 1890 it was customary in this Bank to compare ledger balances as often as every thirty days, but thereafter no comparisons were ever made;[51] and that the employe commenced to abstract the funds of the Bank as soon as this supervision ceased.[52] When this bond was originally pro-

[51] Dep. Boench, q. 6, p. 63.

[52] Trans., p. 13.

cured this supervision prevailed in the Bank. It then and now universally prevails in all other banks, and is the only possible way banks have of knowing anything about their condition, and in no other way can the books of the bank be kept in balance, or their condition be known.[53]

The first act of supervision would be to see that the books in the Bank were kept in balance. This was not done during the entire year. At the beginning of the year they were out of balance $19,600; at the end of the year, $69,700—nearly twice the capital of the Bank, and nearly one-half the total deposits.[54]

The next act of due supervision would be to see that the assets called for by the Bank's books were in the Bank. At the beginning of the years the notes in the Bank were $3,765.44 less than the books called for; at the end of the year they were $4,015.44 less.[55] The total amount of the notes in the Bank were less than $200,000.

The by-laws of the Bank required the cashier to see that all the accounts and books of the Bank were properly kept.[56] The cashier, during the whole of 1892, was an expert bookkeeper.[57] He states that he was never present at any examination, and merely copied the statement of assets and liabilities from the daily balance book as his report to the directors.[58] Although an expert bookkeeper, he did not exercise sufficient supervision over the books of the Bank to see that they were in balance. Starting at the beginning of the year out of balance $19,600, they ran up to $69,700 at the end of the year, yet the expert bookkeeper, charged by the rules of the Bank with this duty, failed to supervise them sufficiently to discover that they were out of balance at all.

It is certain that "due and customary supervision *to prevent a default*" was not exercised by the Bank.

This record affords a very striking illustration of the necessity of due supervision of employes to prevent a default. This employe was honest and faithful *until* the Bank *ceased* to exercise due supervision. The books were kept in balance until just before

[53] Dep. Harris, p. 62; Dep. McLaughlin, p. 67; Dep. Duncan, p. 69--71; Dep. Fischer, p. 74, 75.

[54] Dep. McEwen, cross-q. 43, Trans., p. 35.

[55] Dep. McEwen, cross-q. 43, Trans., p. 35.

[56] Dep. Pryor, q. 11, Trans., p. 59.

[57] Dep. McEwen, q. 4, Trans., p. 76.

[58] Q. 7, Trans., p. 66.

the defalcation commenced. The ledger balances were compared each thirty days, and made to agree. So soon as this act of supervision *ceased*, the defalcation *commenced*.

With respect to the other condition of the bond requiring an inspection and audit of the books and accounts at least once a year on behalf of the employer, it is not contended that the finance committee did not *partially* examine the *assets* of the Bank, no doubt with a view of declaring dividends, but there was no "inspection or audit of the *books and accounts of the employe*" during the year 1892. This language clearly contemplates a reasonable, careful, and prudent examination of the books and accounts of the employe in order to ascertain their condition. There is not a page of the books kept by the employe during the year 1892 that is correct, and that could not have been found to be false if examined.

The words "inspection or audit" have a meaning well understood. They have no reference to the financial condition of the Bank. They refer to the particular books and accounts kept by this employe, and *these* books and accounts were required to be examined. There is no pretense that this was done, and hence this condition of the bond was breached.

VI.

CONCLUSION.

It is apparent from the record and the defenses urged by the Company to defeat a recovery under each bond, that each and every defense is based upon matters affecting the merits of the risk assumed. Each and every one of them relate to matters which were of the essence of the contracts. They are not technical, do not relate to matters occurring after the loss, but they concern matters which were intended to, and which would have prevented loss to the insured, if observed in any degree of prudence and care.

No greater care, and no higher degree of skill is insisted upon by the Company than such as reasonably prudent bank officers usually possess and exercise. The Company does not insist that the Bank officials should have exercised any more prudence and good faith in dealing with it than the prudence and good faith legally and morally required of bank officials in all other dealings

between them and other persons. But this much is insisted upon, and should be sustained by the Court. And the record abundantly shows that the officers of this Bank were intelligent and *knew* what their duty was, even though they did not perform it.

The loss would not have occurred if the Bank had observed *any* supervision, much less "all due and customary" supervision over its employe. The Bank would not have procured either bond, if it had reasonably examined the books and accounts of the employe, and have correctly represented the facts. The Bank would have been saved from insolvency, if it had reported the speculation and "bucket shop" dealings of the employe, as it agreed to do; and had not accepted the statements of the employe without any independent investigation; and the cashier's bond would never have been obtained, if the Bank had not withheld the information it had touching the disreputable conduct and habits of its employe. The Bank obtained each bond, not through ignorance, but through neglect and bad faith, and it should not be permitted to profit by that same neglect and bad faith.

If the bad faith of the Bank is not shown in *each* of these defenses, certainly it is shown when *all* the defenses are considered together. The record discloses that the Bank did *nothing at all* to comply with its part of these contracts, and obtained them by reckless and untrue statements.

A sound public policy demands that bank officers be required to exercise good faith and reasonable prudence in the conduct of affairs intrusted to them, and it would be contrary to public policy, and greatly detrimental to the public interest, for the rule to be established that the officials of corporations can dispense with all care in overlooking employes under them if they hold a bond for a fraction of the amount which such employes may embezzle.

If the holding of the Court in this class of cases is to be that the employer, in seeking such bond, is not bound to make disclosure of such facts as may be known to him affecting the reliability of the employe sought to be bonded, even when asked in regard thereto by the bonding company, and that an answer which can by any possibility be excused as not being in bad faith, shall not be deemed a misrepresentation avoiding the bond, and that, *after procuring such a bond*, the employer is bound to no duty and to no diligence in regard to a supervision of the employe, and all stipu-

lations looking toward requiring the disclosure of discrediting facts known to the employer, either at the time of the issuance of the bond or becoming known to him therafter, or stipulations regarding the supervision of the employe, are to be construed against the company with the utmost strictness and harshness, it will have the effect to increase greatly the hazard and risk of the business to the companies engaged therein, and will result in the permanent injury and loss to the public seeking such bonds, by requiring large increases in the premiums paid therefor, to cover the additional hazard and risk so incurred. It will tend to the relaxation of the duties required by law of all bank officers, and can but be detrimental to the interests of the creditors and stockholders.

The decree of the Circuit Court of Appeals, affirming the decree of the Circuit Court, should be reversed, with direction to dismiss the bill.

Respectfully submitted,

WILLIAM L. GRANBERY,

Counsel for Petitioner.

No. 48.

Brief of East for D. E.

Office Supreme Court U. S.
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In the Supreme Court of the United States.

OCTOBER TERM, 1900.

The Guarantee Co. of North America

vs.

Mechanics Savings Bank and Trust Co., to use of James Pryor, Assignee.

In Error to Circuit Court of Appeals for the Sixth Circuit.

BRIEF OF

EDWARD H. EAST,

SOLICITOR FOR DEFENDANT IN ERROR.

MARSHALL & BRUCE CO., NASHVILLE.



In Supreme Court of the United States

OCTOBER TERM, 1900.

Guarantee Company of North America,
PLAINTIFF IN ERROR.

v.

Mechanics' Savings Bank and Trust Company,
DEFENDANT IN ERROR.

IN ERROR TO THE CIRCUIT COURT OF APPEALS
FOR SIXTH CIRCUIT.

May it please the Court:

This record is brought to this court by certiorari to the Court of Appeals for the sixth circuit, to review a judgment of that court affirming, with some modification, the judgment of the Circuit Court of the United States for the Middle District of Tennessee, in favor of J. J. Pryor, assignee of the Mechanics' Savings Bank & Trust Company, against the Guarantee Company of North America, a Canadian corporation, for the amount of two bonds given by plaintiff in error, insuring the bank against loss by dishonesty of its teller, John Schardt, and the same person

as its cashier, he having filled the two positions in succession.

The opinion of Circuit Court is in 68 Fed. Rep., 459.

The opinion of Court of Appeals affirming is in 80 Fed. Rep., 766.

The opinion on petition for rehearing in 82 Fed. Rep., 545.

Opinion of Supreme Court is in 173 U. S., 587, remanding to Circuit Court.

Opinion of Circuit Court of Appeals on second hearing, — Fed. Rep., ——, and in this record.

IN RE OF TELLER'S AND COLLECTOR'S BOND.

The teller's bond is dated January 16, 1888, and was renewed from year to year until January 1, 1893. This bond was in the penal sum of $10,000, for which the bank paid $100, and, to effect a continuation of said bond for ensuing years, a like consideration was to be paid by the bank annually, which was done, and the bond was continued current until the sixteenth day of January, 1893.

The condition of the bond is:

"To make good and reimburse to the employer such pecuniary loss as the employer shall have sustained by the *fraudulent* acts of the employe, in connection with the duties of said office or position, or with any other duties assigned to him by the employer in the said service, committed by him, and discovered during the continuance of this bond, and within six months from the employe ceasing to be in said service."

There are many conditions and provisions attached to this bond, and agreed to be observed, not necessary to notice in this litigation. I here quote such only as it is insisted are necessary to the adjudication of this case, and are agreed to be "observed and binding as a part of this bond:"

"That this bond is *issued* and *renewed* on the express understanding that the employe has not, within the knowledge of the said employer, at any former period, either in this or other employment, been guilty of any default or serious dereliction of duty.

"That the employer shall observe, or cause to be observed, all due and customary supervision over the said employe for the prevention of default, and if employer shall, at any time during the currency of this bond, condone any act or default on the part of the employe which would give the employer the right to claim hereunder, and shall continue the employe in his service, without notification to the company, the said company will not be responsible hereunder for any default which may occur *subsequent* to said act or default of said employe so condoned.

"That the employer shall at once notify the company, on his becoming aware of the said employe being engaged in speculation or gambling, or indulging in any disreputable or unlawful habits or pursuits.

"That there shall be *an inspection* or audit of accounts or books of the employe on behalf of the employer at least once in every twelve months from date of this bond."

The bond also declares in its preamble the following:

"And, whereas, the employer has delivered to the company a certain statement, and it being agreed and understood that such statement constitutes an essential part of the contract hereinafter expressed."

This statement is nowhere identified or more definitely pointed out.

The Guarantee Company contends that the paper referred to is the one signed by C. W. Peden, the then cashier of the bank, as this was the only paper delivered to the company either before or contemporaneously with the execution of the bond, and which consists of questions and answers.

On this theory, I now quote such questions and answers as are supposed to enter into this lawsuit:

Question 8. What is your custom in regard to frequency of *inspection?* Are they at stated periods or irregular, and what is the longest time allowed to elapse between inspections?

Answer. Every quarter.

Question 9. Has the bank a duly appointed and authorized inspector or inspectors. If not, by whom are the inspections made?

Answer. The finance committee.

Question 18. In the event the employe filling the post of teller, how often, and by what officer will the teller's cash be checked and counted?

Answer. By finance committee quarterly.

Rec. 87, 88.

The questions and answers are concluded by this declaration:

"I hereby declare that the answers and representations above made are true, and that I am not aware of any matter or thing affecting the character or reputation of the applicant which should create any doubt as to his reliability or trustworthiness.

"Dated at Nashville, Tenn., this 21st day of January, 1888. (Signature) C. W. PEDEN,

"Cashier, on behalf of bank."

Rec. 88.

There is no effort in this bond to make these statements

and declarations warranties. There are no warranties in this bond.

The teller's bond was renewed from year to year by the payment of the $100 by the bank, and without any specific questions or answers additional, but before the bond was renewed each year the defendant company sent out to its patrons a printed circular, in which, among other things, was the following:

"It is necessary, before the bond can be renewed, that you obtain the certificate on the back hereof, by your president or cashier, and on its return with remittance of the premium, the renewal can be immediately effected."

Rec. 89.

The certificate on the back was filled up and signed by the cashier, and, among other things, it stated that the accounts of said teller, Schardt, had been *examined* and *verified* by the finance committee of said bank, and the bond was not renewed any year until this certificate had been made out and delivered to the defendant company.

Rec. 89.

This statement only applied to the teller's bond.

The embezzlements as teller and collector commenced September 12, 1890, and continued during the currency of the several bonds, successively, to January 1, 1893, when Schardt became cashier, vice Sykes, resigned.

The embezzlements, as shown by the experts, are subdivided, as follows:

From Sept. 1, 1890, to Jan. 16, 1891	$ 5,879.34
From Jan. 16, 1891, to Jan. 1, 1892	22,290.00
From Jan. 1, 1892, to Jan. 1, 1893	50,649.90
Total (record, page 28)	$77,819.24

HOW EMBEZZLEMENTS WERE COVERED ON THE BOOKS.

These various embezzlements were covered on the books of the bank, and detection prevented:

1. By false additions.
2. Failure to enter notes discounted.
3. Failure to enter money collected.
4. Failure to give proper credits to depositors on the books of the bank.
5. Failure to credit on the books of the bank interest paid on notes.

Rec. p. 29, q. 4; Rec. 41, q. 10.

Nearly all of the embezzlements were covered on the books by misstating the amount due depositors upon the books kept by Schardt.

Rec. 32, q. 14; q. 23, p. 33.

The expert, McEwen, and others, when asked if these abstractions and embezzlements were easily detectable from the books of the bank, testified:

"They could easily have been detected by an expert bookkeeper. His falsifying of the books was done, in main, in false additions on the cash book, and whenever this was done he nearly always falsified the general account of individual depositors on his general ledger, to correspond with the errors made on the cash book. A few of his false additions on his cash book were covered up by falsifying one or more of his other accounts on his general ledger. The amount shown as due individual depositors by the account on the general ledger, was far less than that actually shown to be due by the pass books of depositors."

Rec. 29, q. 5.

The two expert bookkeepers (McEwen and Jennings), with their assistants (Fisher and Northern), were engaged in this work "several months."

Rec. 29, q. 7.

It was necessary to refer to various and different books. (Rec. 29, ques. 10.) All pass books had to be called in. (Rec. 29, ques. 10.) In some instances no deposit tickets could be found.

Rec. 29, q. 11.

BOOKS KEPT BY THE BANK (Rec. 30, ques. 4.)

1. Individual ledger, kept by a clerk.
2. General ledger, kept by Schardt until made cashier.
3. Cash book, kept by Schardt until made cashier.
4. Daily balance book, kept by Schardt until made cashier.

Pryor gives the books kept by the bank, as follows: General ledger, individual ledger, cash book, deposit register, check register, discount register, and such auxiliary books as experience showed to be necessary.

Rec. 59, q. 10.

The individual ledger showed the deposit account of each individual depositor.

General ledger shows every account in the bank except that of individual depositors, viz.: Demand loans, discounts, bonds, stocks, and such. It has also an account showing in totals the deposit made and checked out each day by individual depositors. This book was kept by

Schardt from beyond 1890 to the time the bank closed (April 17, 1893).

The cash book shows the same things as the general ledger, except that instead of putting the business of each day under various accounts, they are grouped together on one page in the cash book, and shows at a glance the entire business transacted by the bank during the day.

This witness testified that the fact that Schardt was permitted to keep the general ledger and act as general bookkeeper in the bank, greatly increased his facilities for embezzling the funds of the bank. (Rec. 32, ques. 16.) Also, he was asked: "Would it have been possible for Schardt to have embezzled funds of the bank to any extent without detection if he had not been permitted to keep the general ledger?" The answer is: "It would not have been possible for him to embezzle the funds in the manner he did if he had not been permitted to keep the general ledger and balance book." (Rec. 33, ques. 20.)

It will be observed that what is designated herein as the teller's bond, was given upon the idea that Schardt had been assigned to the office or position of teller and collector (rec. 10), and covers any pecuniary loss which the bank shall sustain in connection with the duties of the said office or position, or with any other duties assigned him by the employer in said service. (Rec. 10.)

This witness when asked concerning a trial balance book, said: "I saw a book of that character when I went in there, but it was incomplete, the balances not entered up, and I paid no attention to it, and I do not know for what years they were taken off." (Rec. 33, ques. 21.)

This trial balance book was left off in 1890, by the orders of Schardt. (Rec. 62, Boensch Dep., question 6; ques. 15.)

In the examination of these witnesses, many hypothetical questions were put by the defendant as to how, and whether these embezzlements might have been easily detected had the officers of the bank suspected Schardt, and resorted to them, all of which resulted in negative answers, except as follows: One expert said: "They could, upon any day, at close of business, have taken the daily balance book showing a record of the condition of the bank at the time, and counted the notes on hand, bills receivable, bonds and stocks, and cash, and could then have verified the amount appearing to be upon deposit in other banks to the credit of complainant bank, and this would have only left to be verified the amount shown to be due depositors, and the way to verify this would have been to have taken from the individual ledger a trial balance, which would have shown the amount due depositors by the bank, and if this had agreed with the amount appearing upon the daily balance book to be due depositors, the officials of the bank would have verified his accounts as clearly as possible." (Rec. 32, ques. 12.) This, he said, should not, in a bank of that size, have taken over twelve hours. (Rec. 32, ques. 13.)

The other expert (Jennings), said: "No person not an expert bookkeeper could have found many of those manipulations, but it would not have been difficult for any one who could add columns to have seen some of these false

additions, which would have resulted in causing suspicion that some wrong was intended."

Rec. 41, q. 11.

Jennings also testified, in respect to the time it would have taken: "Of course it depends upon the rapidity of the work of the bookkeeper. I should think twenty-four to thirty-six hours would be sufficient for an average bookkeeper to do that work." (Rec. 42, ques. 9.)

BY-LAWS OF BANK AS TO DUTIES OF TELLER AS BOOKKEEPER.

"The teller shall also be the general bookkeeper of the bank."

The evidence shows that no system of bookkeeping will detect or prevent embezzlements, including taking trial balances, and that it is not possible to ascertain the financial condition of a bank without stopping the bank for a time, call in all the pass books, and have an expert go through the whole.

Rec. 61, dep. of A. W. Harris.
Rec. 71, dep. of Duncan, q. 33.

The evidence shows that in small banks it is customary for the teller to keep general ledger.

Rec. 69, q. 5, et seq.; Rec. 71, q. 27.

It cannot be contended, in view of this contract, that it was wrong to allow Schardt to keep the book known as general ledger, and that Guarantee Company can say successfully that this enabled Schardt to commit and conceal

his embezzlements. The contract prepared by the Guarantee Company, and submitted to the bank, is "to make good and reimburse to the employer such pecuniary loss as the employer shall have sustained by the fraudulent acts of the employe in connection with the duties of his said office or position, or with any other duties assigned to him by the employer in the said service."

The proof shows that it is not customary for financial committees, in examinations, to go through original entries on the books, but it is customary for them to accept statements made by cashiers, officers, and clerks.

Ducan dep., Rec. 71, q. 31.
McLaughlin dep., Rec. 68, cross question 2.
A. W. Harris dep., Rec. 61, qq. 3, 4.

There was, at all times, a financial committee consisting of five members; generally, three acted.

The evidence shows conclusively that the finance committee made quarterly examinations into the bank's condition, and also semi-annual examinations. The main purpose of the latter was to ascertain the ability of the bank to pay a dividend. The mode and extent of these examinations are stated differently, but substantially concur. Eatherly says:

"Mr. Schardt made out a list of assets of the bank, and that list was taken charge of, generally, by myself and a portion of the finance committee. We went to where the securities were kept, and took them to the directors' room, or rear part of the bank, and compared them with the amounts given on the list, to see whether they corresponded. We examined the collateral, or evidences of them, to see if they were there. We counted the cash on hand, and had generally a certificate from the

banks where we deposited, to the amounts in those. We then compared the footings with the amount as shown on the daily balance sheet or balance book, to see whether they agreed with them. We found no discrepancies except in cash on hand in a few instances. Generally, there was a discrepancy of a few dollars between the money on hand and the amount shown by the daily balance sheet. Sometimes it was a deficit and sometimes a gain, but generally a deficit."

Rec. 42, 43. McEwen's Dep., 75.

This custom was habitual and continuous.

In addition to these quarterly examinations, annual reports were submitted to the directors by the cashier. The president, or some one or more of the directors, was present in the bank at all times.

Rec. 43.

Eatherly admitted that had the finance committee procured from the individual bookkeeper the total amounts shown by his books to be due individual depositors, and compared it with the amount shown by the daily balance book kept by Schardt to be due individual depositors, it would have disclosed the fact that something was wrong with the books.

McEwen testified, in respect to these quarterly examinations, as follows:

"We counted all the money, or things that represented money, such as cash tickets, checks on other banks, deposits in other banks, and compared this with the statements furnished us by the cashier or teller. Then we took possession of all notes, bills, time or demand loans, or other paper showing an indebtedness to the bank, as well as collaterals, and did our best to ascertain the condition of the paper, and value of collaterals. We compared this

with statements furnished by the cashier or teller of what should be in the bank of those kinds of paper, and also compared it with the daily balance book. As we had seen all notes or bills which had been discounted by the bank, and these had been entered on the daily balance book, we would sometimes go back to it. We always took the cashier's or teller's written statement of the deposit account. We hardly ever examined original entries of deposits, but accepted this statement as making a full and fair exhibit of these. We could not have examined original entries. There were several hundred depositors, and a great many small accounts with individuals. It would have taken all our time to have done this, and but few, if any of us, were bookkeepers or accountants. We had to rely upon the honesty of the cashier for this. We did our best to ascertain the exact condition of the bank at the end of each quarter. The finance committee was the discount committee, and all paper approved by the committee was recognized by the committee at the quarterly examination. If we did not remember it we appealed to this book of original entries on the ticket. The quarterly examinations were of the same kind and character which all the banks of Nashville made, as we understood."

Rec. 77, q. 17.

"Every July and January of each year the directors and finance committee made an examination into the affairs of the bank with a view to ascertaining the ability of the bank to pay a dividend. These examinations of the directors and finance committee were as thorough as we could make them."

Rec. 77, q. 23.
J. B. Richardson dep., Rec. 79.
Rec. 81, q. 3.

The defendant company had a general agent (Cooley) resident in Nashville. It is a part of the duties of this general agent to gather information concerning applicants for bonds, and about persons already bonded in defendant company, and to transmit such information to the home

office. To this end the agent employed detectives at discretion, and took information from outside parties.

ARGUMENT IN RESPECT TO TELLER'S BOND.

I.

It is said in argument by my opponent that the bank procured the teller's bond for the year 1892, and all previous years, to be renewed by representing that the employe's books and accounts had been "examined and verified," when in fact, no such thing had been done, and, had it been done, his previous defaults would have been discovered.

I desire just here to clear the case of an obscurity which may lead to confusion and error.

When the bond was made for the year 1888, it contained the following: "And, whereas, the employer has delivered to the company a certain statement, and it being agreed and understood that such statement constitutes an essential part of the contract herein expressed."

Rec. 10.

The statement there referred to as an essential part of the contract has no reference to the statement made in the circular, above referred to, stating that the accounts and books had been "examined and verified," but refers to the statement signed by C. W. Peden, cashier, on pages 86, 87.

Stipulation. Rec., p. 86.

The statement contained in the circular sent out, before the renewals of the bond, to the effect that the books and

accounts had been "examined and verified," is no part of the original contract, and is nowhere called for in the contract, or as a condition to its renewal. It was a paper voluntarily sent out from the chief office, at Montreal, and among other things, contained the words ascribed to it on page 85 of the record, and was filled up and signed, and sent back to Montreal. The paper referred to in the body of the bond and as constituting "an essential part of the contract," is the one setting out the questions and answers as shown on pages 86, 87 of record.

II.

I have quoted hereinbefore all the provisions and conditions of the contract, and all the duties and obligations assumed by the bank, as respects this employe, or his books and duties.

The defenses to this suit involve, necessarily, the question of the proper construction of the bonds and rights of the respective parties thereunder, rather than any conflict about the facts.

Here are contracts prepared and printed by the company, which it tenders to the public, by which it undertakes and obligates itself to indemnify and make good to its patrons any pecuniary loss occasioned by reason of the dishonesty of their employes.

The contract implies that employes will have opportunities to embezzle and steal, and that they will not avail themselves of these opportunities, or if they do, the com-

pany will make good their thefts and embezzlements to the employer.

These contracts amount to nothing if the conditions and provisos are so arranged by the use of general language, that there cannot be a theft or embezzlement for which a recovery may be had, because the employer gave the employe the opportunity to accomplish it and to conceal it.

No opportunity to accomplish the theft or embezzlement, or no opportunity to conceal it, when it is accomplished, implies no risk, and reverses the relation of the parties, as assumed in the very purpose of the contract.

The one gives a bond to indemnify and save the other against loss, and the other concedes conditions by which the bond is made practically ineffective for the purpose intended.

The Guarantee Company insures the bank against loss, and, in turn, the bank guarantees that the company shall not suffer loss, because it would give such efficient supervision over the employe and his books as will be sure to prevent loss. Hence, the premium is paid and no risk assumed.

The bond will be construed to give indemnity unless there are unambiguous, clear, and positive words to prevent it. There will be no implication against the purpose of the bond. All risks will be put upon the guarantor, in every respect, unless he has qualified it by apt and unmistakable language clearly intended for and expressive of that purpose.

III.

IS THE RELATION THAT OF SURETY AS GENERALLY UNDERSTOOD?

The Guarantee Company is a compensated guarantor, who, by express contract, undertakes to make indemnity, and to limit his liability. The ordinary surety is not compensated, and usually has no voice in the contract, and makes no limitations upon the extent of his liability. He signs the bond and leaves it to the law to determine the extent of his obligations, and to limit or qualify them accordingly as he has been treated. Hence, it has been held that if the obligee actively conceals facts material for the surety to know, it will operate to discharge him.

Rees v. Benington, 2 Ves. Jr., 540.
2 White & Tudor Lead Cas., 1106.
Roelton v. Mathews, 10 Clark & F., 934.
Hamileon v. Watson, 12 Clark & F., 109.

In compensated suretyships the latter prepares the contract; in its every detail determines for himself what he desires or cares to know; puts searching questions to this end; makes conditions and provisos as to his ultimate liability. He leaves nothing to the law except the effects of fraud that may be practiced upon him. In these latter days corporations are organized to be, and become compensated guarantors or sureties, for the fidelity of employes. They claim in one aspect to be strict sureties, and when sought to be held liable, invoke to their aid every principle of law or equity applicable to that relation. In another

aspect they claim to be *insurers*, and invoke to their aid all the niceties and warranties of insurance law, especially those regrettable technicalities which recent legislatures have swept away, and which so long perplexed the courts.

Strictly, they are neither the one or the other, but partake of both—are original—and must be dealt with as originals in the future.

IV.

"EXAMINATION AND VERIFICATION."

Our opponents insist that upon each annual renewal of the teller's bond, the company sent out from Montreal a circular to the bank, which it was necessary for some officer of the bank to sign and return, and that among many other things contained in said circular, were the following: "The accounts of said teller (Schardt) had been examined and *verified* by the finance committee," and that this was a condition precedent to the renewal. That, in fact, the account had not been examined and verified; and, therefore, it was a falsehood, and deceived the company in the issuance of the bond, being a material and important fact.

We say that the original contract made all arrangements for these renewals, and fixed in advance the terms and conditions thereof.

Its language is:

"Now, therefore, in consideration of the sum of one hundred dollars, lawful money of the United States of America, to the said company (paid), as a premium for the

term of twelve months, ending on the sixteenth day of January, 1889, at twelve o'clock noon, *and in order to effect a continuance of the currency of this bond*, a like premium hereafter to be paid to the said company on or before the sixteenth of January in each year, as a premium for the ensuing year, so long as said employer may wish to continue this bond, and the said company shall consent to receive said premiums," etc. (Rec. 10.)

Here is no reservation for either party to alter the contract, and no notice that there would be any effort to change it. On the contrary, the parties agree to annual renewals upon "the payment of a like premium *hereafter* to be paid to the said company so long as the said employer may wish to continue this bond, and the said company shall consent to receive said premiums."

Cumulative to the above, the bond recites:

"The following provisions are also to be observed, and binding, as a part of this bond. The actual payment of the premium, and its acceptance by the company, either for the issue or renewal of this bond, is essential to its currency, and a condition precedent to the right or claim hereunder."

Rec. 10.

Again, we have: "That this bond is issued and *renewed* on the express understanding that the employe has not, *within the knowledge of the employer*, at any former period, either in this or any other employment, been guilty of any default or serious dereliction of duty."

The foregoing constitute all the conditions for the annual renewal on the bond. After the expiration of a twelve month, the contract is to be renewed. As respects

time, a *new* contract is made, but it contains only the terms of the old contract. May says it is generally held to be a new contract upon the terms and conditions stated in the policy expired, the old application, in the absence of evidence to the contrary, serving as a basis of the new contract, and as if made at the date of renewal.

May on Ins., § 70a.

As respects the "examination and verification" of the books or accounts of this office, not one word is said in the original bond. I now quote what it does say:

"That there shall be an inspection or audit of the accounts or books of the employe on behalf of the employer at least once in every twelve months from the date of this bond."

The company had put a number of questions to the officers of the bank, which were to be, and were, answered, to ascertain, before taking the risk, the habits of the bank in respect to these very matters, such as "When was the last *inspection* of the office?" "What is your custom in regard to the frequency of *inspection?*" "Are they at stated periods or irregular?" and "What is the longest time allowed to elapse between inspections?" "Has the bank a duly and authorized inspector? If not, by whom are the inspections made?" "In the event of the employe filling the post of teller, how often, and by what officer, will the teller's cash be checked and counted?" And, to conclude it all, the contract declared in express words: "That there shall be an inspection or audit of the accounts or books of the employe, on behalf of the em-

ployer, at least once in every twelve months from the date of this bond."

This circular, which contains the words, "examination and verification," it is now claimed, requires more of the bank than was required by the original contract, or than is expressed by the words, "inspection or audit," and an effort is thus made to alter the contract in a sidewise, unadvised, and unconscionable manner.

Our contention is, that under this contract the bank was required to do certain things in respect to the books and accounts of its teller, and these things, we claim, it did, and this contract was to continue from year to year, upon the payment of the premiums, so long as the one paid and the other accepted it. At the end of the year, and when the bank had determined to continue the contract for another year, and to pay the premium, this paper, not purporting to change the contract or the duties of the bank, then past and ended, came to the bank, and hidden in it are the words, that the teller's accounts had been "examined and verified" by the finance committee, whatever these words mean. We insist that said statement, in respect to "verification," was not a condition of the original contract, as set out in the bond or guaranty; was not called for therein as a condition precedent to renewal, but was intended as a catch, slyly and cunningly devised to defeat ultimate liability, and to entrap the unwary.

We further contend that the words of the original contract are the contracting and controlling words of the parties, measured by each before executing the contract, and

fixed forever their rights and duties under *that* contract so long as it existed, as between themselves, and that its legal effect was not to add anything to the contract as a condition or provision, but should be construed in connection with and to have reference to the words, "inspection or audit," as set out in the original contract. That having required the bank to perform specific duties in the original contract, it cannot subsequently limit its liability and defeat the entire contract by requiring the bank to do those same things by using stronger words, or increasing the bank's duties beyond its original contract. Nowhere in the original contract had it exacted of the bank a "*verification*" of the accounts of the teller. "Verification," as now contended for, means such an examination and comparison, inspection and scrutiny of the books and accounts of the teller as would detect any embezzlements, however cunningly contrived or hidden upon the face of the books. If these companies will make it apparent or visible upon the face of the contract what is now and here contended for, they will quit the field of competition for business and patronage quite soon.

The condition of the original contract, and of each renewal was: "That there shall be an *inspection* or *audit* of the accounts or books of the employe, on the behalf of the employer, at least once in every twelve months from the date of this bond." (Rec. 11.) This is what the bank agreed to do, and this is what it understood it was certifying it had done. It is argued here as if the bank had made a contract for such effective and absolute supervision as would detect and prevent abstractions of its funds, and

in this circular solemnly certified that it had done so, and the bond was renewed on the faith of this statement, as if it was a guaranty on the part of the bank that the past was forever closed, and that the bank had somehow estopped itself from looking into past embezzlements, and that it would be a fraud on its part to insist thereafter there were or had been embezzlements.

The court will observe that the very words of the contract put the only limitation upon retro-examination and discoveries in this language: "Committed by him and discovered during the continuance of this bond, and within six months from the employe ceasing to be in said service" (Rec. 10), showing thereby that back inspection of the books of the employe were intended, notwithstanding a renewal in the meantime. The effect of the contention of our opponents, in view of all the facts, is this: The bank agreed to make an "inspection or audit" once in every twelve months, and then at the end of the twelve months, to make the bank say that it had "examined and verified."

V.

ASSIGNMENT OF ERROR ON TELLER'S BOND.

The first assignment is made on the agreement of the bank to notify the company on becoming aware of the employe *being* engaged in speculation, and it is claimed that the bank learned that the employe had not only been speculating, but had been a part owner in a gambling con-

cern, and neither investigated the matter on its own account nor notified the company.

This assignment is based upon a condition in the bond, as follows:

"That the *employer* shall at once notify the company on his becoming aware of the said employe *being engaged* in speculation or gambling, or indulging in any disreputable or unlawful habits or pursuits." (Rec. 11.)

The proof on this is that Eatherly, a director in the bank, saw an anonymous letter addressed to Woodard, in which it was stated that "Schardt was a partner in a bucket shop." He showed the letter to Schardt, who said, "It is a lie, and I can prove it," and went out and returned with Searight and Barry, saying, "Here are the men who can tell you whether that is true or not." It resulted in this: Searight said: "Some time before that Schardt, Barry, and he had agreed to open a brokerage association. Each one was to put in $200. Schardt, in a short time, became dissatisfied, and sold his interest to Searight at a small loss." This anonymous letter was just prior to the resignation of Judge Woodard. Woodard's resignation bears date of February 17, 1893, and was accepted March 25, 1893.

So it is doubtful, so far as this witness is concerned, whether any of this matter relates to the time the teller's bond was in force.

This proves that he took stock in a brokerage association to the amount of $200, and sold out at a small loss in a short time.

A brokerage association neither buys or sells for itself, and is but the broker or agent of others, engaged in speculation on the boards of other cities.

I have cited in appendix hereto the various acts of the Legislature of Tennessee, from the act of March 30, 1883, to April 30, 1893, showing that dealing in futures, "whether actual delivery is intended or not," was a privilege and licensed during this time by the State, and was not gambling or gaming, or in any sense unlawful, and the Supreme Court so held, in *State* v. *Duncan*, 16 Lea, 79, 80.

To prove that a man was a stockholder in a brokerage association does not necessarily prove that he was speculating or gambling or indulging in any disreputable or unlawful habits.

"Purchase and sales of stocks by an officer in a bank is not ipso facto evidence of dishonesty, but if such officer be engaged in stock gambling, or buying and selling beyond his means, he should not be continued in a place of trust."

Scott v. National Bank, 72 Pa. St., 471.

The other witness called to prove that Schardt speculated, was Sykes, the cashier, and acted as such during the year 1892, *and who recommended Schardt as his successor*, and who had litigation with the bank at the time his deposition was taken, arising out of his conduct as cashier. He testified that a man named Kyle, who represented Myers & Co., of New York, told him in the summer or fall of 1892, that Schardt was a part owner in a brokerage association, and that he told Schardt what Kyle had told him, and that Schardt admitted that "he, at one

time, had been interested in such a concern but had sold his interest." Sykes also testified that Schardt told him that "he had speculated to some extent, but made money." He also refers to the anonymous letter. Says he thinks he told Baxter, the President, of these things.

Do the foregoing constitute "becoming aware?" The word "aware" is not used here in the sense of "heard," as in the cashier's bond. "Aware" is universally defined as "possessing knowledge," "conscious," "cognizant," "informed through the senses," and is a synonym of "certain," "certified," "sure."

This court held that a provision like the foregoing, "requiring written notice to the obligor of any act of the cashier involving loss to the bank, to be given as soon as practicable after the bank had knowledge of such act, does not require notice upon suspicion, but only after the bank has knowledge of such *facts* as would justify the charge of fraud and dishonesty against the cashier."

American Surety Co. v. Pauly. 170 U. S., 131 (42 L. C. P. Co., 977).

"*Being* engaged in speculation or gambling or indulging in any disreputable or unlawful habits or pursuits," certainly implies some continuing and substantial manner, either as to *time* of its continuance, or magnitude of the transactions, not to one or two, or even more times, in the past.

"*Being engaged*," is not the same as having been engaged. The one is present tense, the other a past fact when first heard of. "Being engaged in speculation or gambling or indulging in any disreputable habits or pur-

suits," are all words of the present tense. Had it been the mind of the company to have refused its insurance to one who had ever been guilty, at any past period of his life, of any of these things, it could have said so plainly. Not a single transaction of gaming is shown, not the loss of a dollar. It does seem, if he did lose so large an amount, either in Nashville or New York or elsewhere, some one loss or speculation could have been shown. I concede that it is a probable inference, but is not a proven fact; and had the bank dismissed him for any of these causes, if sued for slander, it could not have defended itself against damages, or if it had written the company that he was doing any of these things, it would have been a libelous charge, which it could not justify or have found legal excuse for.

It is quite clear that the bank was not obligated under this contract, or independently of it, to ransack Schardt's past life, or to run down rumors and suspicions and report them to the Guarantee Company. The company had its agent at Nashville to do this character of work.

State v. Atherton, 40 Mo., 207 11 (C. C. A.).

The insistence of the Guarantee Company is that "becoming aware," is synonymous with "having heard," "rumor," "suspicions," and "being engaged," means in this contract "having been engaged," in the indefinite past.

There is no doubt that Schardt took a very large amount of money from this bank, but that he ever had what is commonly known as a gambling transaction, or that he

ever indulged in any disreputable or unlawful habits, or lost a dollar in speculation, has not been shown in this record. It is to-day a surmise what he did with it, and *not a fact*, but an inference, that he lost it in speculations somewhere and at some time. His dying declarations furnished the best evidence of how he lost it, and these came too late for the defendant to successfully use them in this case.

VI.

The next error assigned is:

The bank procured the teller's bond to be renewed in January, 1892, by representing that the employe's books and accounts had been examined and verified, when the books showed a default of $23,365.14 in a bank with a capital of only $50,000.

I have disposed of this assignment heretofore. See page 18 to page 23, so far as it relates to the words "examined and verified," and what is not heretofore disposed of will be discussed with the next assignment.

VII.

The third assignment is:

The bank agreed to observe, or cause to be observed, all due and customary supervision over the said employe for the

prevention of default, and during the currency of the bond, ceased to compare ledger balances, or correctly count the notes held by the bank, which was not only customary with other banks, but was customary in this bank up to the time this shortage commenced.

This assignment is based upon the following condition of the bond:

"That the employer shall observe, or cause to be observed, all due and customary supervision over the said employe for the prevention of defaults, and if the employer shall, at any time during the currency of this bond, condone any act or default on the part of the employe, which would give the employer the right to claim hereunder, and shall continue the employe in his service, without notification to the company, the said company will not be responsible hereunder for any default which may occur subsequent to said act or default of said employe so condoned."

This is another very broad and indefinite expression, an is reasonably susceptible of several interpretations. It is contended on the part of the Guarantee Company that it has but one meaning, and this is, that it relates to the *books* and *accounts* kept by the employe, and is a covenant on the part of the bank that it will keep the same character of books, and keep them in the same manner as is customary with other banks, and thereupon, it proceeds to show that it had been the custom of this bank, up to 1890, to compare ledger balances and take off trial balances as often as every thirty days, and thereafter it ceased, and, in this connection, it says that this custom universally prevailed in other banks, and it concludes by

insisting that this failure, in this particular, avoids the bond, because it was a failure "to observe all due and customary supervision of the said employe to prevent defaults." If this condition be taken, literally, it has no reference to the books of the bank. The words are "due and customary supervision over the employe." It does not say over the books kept by him, or over the work done by him, but over him personally, as respects his habits, association, as well as his prompt and daily presence at the usual and customary hours. The balance of the sentence is consistent with this view, and is inconsistent with the contention of the Guarantee Company, in that it relates to condonements and *personal* matters as distinguished from books and methods of bookkeeping.

Again, the company had made inquiry and been told all it desired to know in respect to the books, *i. e.*, when inspected, by whom inspected, and had put its ultimatum to the effect that they should be *inspected* at least once in every twelve months. It made no objection to what had been told it. It prescribed no methods of bookkeeping. It did not prescribe the extent and vigilance of the prescribed supervision, how it should be done, and what would be expected or required. Besides, the Guarantee Company had been told, in the application or declaration, that there would be an "inspection or audit" of the books and accounts of this employe once in every three months, and that it would be made by the finance committee. The only limitation upon the liability of the Guarantee Company should be found in the clear and unambiguous language of its contract. Indemnity was the purpose of the

contract, indemnity was what the premium was paid for, and there should be no inference against indemnity.

In the case of an ordinary surety upon the bond of an officer of a bank, it has been held "that negligence of the officers of a bank, in failing to examine the books and to discover the defalcations of the paying teller, does not release the sureties on his bond, given for the faithful performance of his duties."

Lieberman v. First National Bank, 40 Atl., 382.
Bank v. Root, 2 Metc. (Mass.), 540, by Shaw, C. J.
Taply v. Martin, 116 Mass., 275.
Bank v. Stephens, 39 Me., 532.
Farmington v. Stanley, 60 Me., 472.
Wayne v. Bank, 52 Pa. St., 343.
Phillips v. Bossard, 35 Fed. Rep., 100.
Sparks v. Bank, 3 Del. Ch., 302.

Graves v. *Bank*, 10 Bush (Ky.), 23, has been overruled in every case in which it has been discussed, and stands alone and unsupported.

Lieberman v. First National Bank, 40 Atl., 386.
Bank v. Albee, 63 N. H., 161.

The company undertook, for the honesty and fidelity of Schardt, absolutely and at all events, and engaged to make good his defaults. The rule is, "It is good faith and not diligence which is required of the creditor as a condition of his right to hold the surety, but the creditor or obligee on a bond is not obliged, for the benefit of the surety, to watch the principal beyond what he literally contracted to do." These sureties would become worthless if due diligence is to be required of directors of a bank. Chief Justice Shaw tersely says (2 Met., 540,) *supra*, "Negli-

gence of directors and their agents is no excuse," and *Judge Thompson (in 52 Pa., 349)*, says:

"I know of no positive duty resting on the officers of a bank to investigate with a view to inform a surety, in the absence of a request, to do so. Neither the bank or its officers knew or had reason to suspect the defalcations discovered."

Even the case of *Graves* v. *Lebanon National Bank*, 10 Bush, 28 (19 Am. Rep., 50), holds:

"The directors may have been negligent in the discharge of their duties, and this negligence may have enabled Mitchell for the time to misappropriate the funds of the bank and conceal its true condition by the false reports made to the Comptroller of the Currency, and by false entries upon the books of the association, but this cannot avail the sureties, who covenanted that their principal should well and truly perform the duties of his position. Their covenant is unconditional, and no failure of duty on the part of directors of the association short of actual fraud or bad faith can be deemed sufficient to exonerate them from its performance."

In the case of *McShane* v. *Howard Bank*, reported in 10 Law. Rep., Anno., 552, is a decision of the Supreme Court of Maryland, and covers several points presented by our adversaries, and holds:

"Acts of bank directors in aiding the executive officers to conceal defalcations and embezzlements of the bank's funds are void."

If, then, active aid given to the cashier in his frauds could not release the sureties of the cashier, it is difficult to see how their negligence could do so, if they were negligent. On this proposition the court held:

"The directors owe a duty of fidelity to the stockholders, and their breach of that duty, by participating in the malversations of executive officers, or by aiding the latter in their attempts at concealment, differs nothing in principle from a case where the directors deliberately authorize a cashier to plunder the funds of the bank or to cheat the stockholders of their interest therein."

The court then repeats the words of this court, in the case of *Minor* v. *Mechanics' Bank*, 1 Pet., 70 (7 L. Ed., 57,) as follows:

"Every act of fraud, every known departure from duty, by the board of directors, in connivance with the cashier, for the plain purpose of sacrificing the interests of the stockholders, though less reprehensible in morals, or less pernicious in its effects than the case supposed, would still be an excess of power for its illegality, and as such void as an authority to protect the cashier on his wrongful compliance."

2. The court further held:

"A creditor is under no obligation to be actively diligent in pursuit of his principal debtor. He may forbear to prosecute his claim and remain inactive without impairing his right to resort to the surety, particularly when his forbearance amounts to no more than mere inaction or passivity." Citing *Gasslor* v. *Young*, 6 Gill & J., 243; *Freaner* v. *Zingling*, 37 Md., 491.

3. "If the creditor is not bound to active diligence, his mere failure to voluntarily give information to the surety of the default of the principal cannot have the effect of discharging the surety." Citing *Forrester* v. *State*, 4 Md., 154; *Pittsburg, Ft. W. & C. R. R. Co.* v. *Shaeffer*, 59 Pa., 356.

4. The court also held:

"It is a sound principle that the failure of one officer of a corporation to discharge his duty does not release the

sureties of another from responsibility for the defaults of the latter. Corporations can act only by officers and agents. They do not guarantee to the sureties of one officer the fidelity of others. The fact that there were other unfaithful officers and agents of the corporation who knew or connived at his infidelity ought not in reason, and does not in law or equity, relieve them from their responsibility for him. They undertake that he shall be honest, though all around him be rouges. Were the rule different, by a conspiracy between the officers of a bank or other moneyed institution, all their sureties might be discharged. It is impossible that a doctrine leading to such consequences can be sound." Citing *Pittsburg Ft. W. & C. R. R. Co.* v. *Shaeffer*, 59 Pa., 356; *Taylor* v. *Bank of Ky.*, 2 J. J. Marsh., 565; *United States* v. *Kirkpatrick*, 22 U. S.; 9 Wheat., 720 (6 L. Ed., 199).

The court further held:

"That if the bank, with knowledge of its officer's default, retained him and paid him salary, or failed to hold to money or securities in its possession and apply them to his debt, will not discharge the surety for antecedent liability." Citing 59 Pa., 356.

"No act or vote of a board of directors in violation of their own duties, and in fraud of the rights and interest of the stockholders of a bank, amounts to a justification of a cashier (or other officer) who was *particeps criminis*."

Minor v. Mechanics' Bank, 1 Peters. 71.

This holding is affirmed in the following cases:

National Bank v. Drake. 29 Kan., 328.
McShane v. Howard Bank, 73 Md., 150 (20 Atl., 779; 10 L. R. A., 556.)
Frelinghuysen v. Baldwin. 16 Fed. Rep., 453.
Phillips v. Bossard, 35 Fed. Rep., 100.

All holding that the cashier or his sureties are not released from liability because of the negligence or misconduct of the president or of board of directors.

Amherst Bank v. Root. 2 Met., 541.

Holding sureties were not exonerated because of the neglect of the directors to examine into the affairs of the bank.

Farmers' Bank v. Sparks, 3 Del. Chan., 303.

Holding that the neglect of directors to supervise the accounts does not discharge the sureties. This applies to sureties of teller.

State v. Atherton, 40 Mo., 217.

To sureties of bookkeeper.

Chew v. Ellingwood, 86 Mo., 272: 56 Am. Rep. 434.

To sureties of bookkeeper.

Frankfort Bank v. Johnson, 24 Me., 504:
Tapley v. Martin, 116 Mass., 278.

Where a cashier committed frauds unknown to the directors, although they were guilty of gross negligence.

Lieberman v. First National Bank, 40 Atl., 384.

Holding sureties of cashier not discharged by failure of directors to examine his books.

United States v. Cutler, 2 Curtis, 625:
Fed. Cases, 14, 911.

Holding surety not discharged because of the failure of the government agents to discharge their duty.

United States v. Robertson, 5 Peters, 666.

Holding that every illegal act of the officers of a bank, although sanctioned by usage, is void.

Minor v. Mechanics' Bank, 1 Pet.

VIII.

FOURTH ERROR ASSIGNED ON TELLER'S BOND.

The bond provided that there should be an inspection or audit of the accounts and books of the employe, on behalf of the employer, at least once every twelve months. Yet the ledger balances were not compared, and the notes in the bank were not counted or compared with the amount called for by the books.

Rec. 14.

This assignment is based upon the following condition of the teller's bond:

"That there shall be an inspection or audit of the accounts or books of the employe, on behalf of the employer, at least once in every twelve months from the date of this bond."

This assignment is not well taken in point of fact—that there was an inspection or audit, as the bank officers understood these words, every three months, and also twice a year, additionally, there can be no doubt.

The real point of this complaint is that these examinations made by finance committee into the condition of the bank, were too superficial to meet the requirements of the bond. It is claimed and insisted that they did not amount to either an "inspection or audit," as these words are understood in the bond, and in proof of this we are referred to the fact that original entries on the books were fraudulent; that the books were full of false additions and other

frauds which a more expert and scrutinizing inspection might and would have detected. Since the experts have taken charge of the books of the bank and called in all pass books from the hands of depositors, and spent several months exploring original entries, uncovering those which were false, pointing out the false additions made in long columns of figures, and shown failures to enter upon the books moneys collected, and how, after making a false entry on one book, he would falsify entries on other books in order to make them correspond as a whole, it is quite easy now to see how these frauds might have been detected by the committee, and how apparently negligent the finance committee must have been not to have discovered them. It is not the business or duty of directors to go back to original entries.

Briggs v. Spaulding, 141 U. S., 132.

Ex post facto wisdom enlarges and sharpens our retrospective vision, so that, in every backward glance we see things lying near to us upon the very surface, the existence of which we never suspected.

The argument of our opponents is that the books of the bank had hidden under their surface every fact now brought to light, which were as open to the discovery of the finance committee as to the experts, and had the committee made a sufficiently rigid and close scrutiny, they, too, could have made the discovery; *ergo*, the bank did not make the contemplated inspection or audit. "This," said the Court of Appeals, "is substantially construing the contract as a guaranty to the defendant company against

the bank's carelessness in making the examination," and I might add, as guaranteeing to the company that each inspection or audit closed the matter forever to that date.

Insurance is taken to secure the insured against his own negligence or inexpertness, as well as that of his agents and servants. It is nowhere contracted that these inspections or audits, wherever made, should be infallible. If so, there would be little necessity for insurance.

It is said that it contributed to the teller's opportunities to embezzle successfully and avoid detection, by allowing him to discontinue, in 1890, the trial balance book. I do not understand, if original entries were false in one book, and all the other books were made to conform to this, how a trial balance taken from these false entries would have detected anything. The company undertook to guarantee to the bank Schardt's honesty and fidelity to his trust, and especially, that he would not embezzle the funds of the bank, even should he have an opportunity to do so. It seems now probable that Schardt dropped the use of the trial balance book as a part of his scheme to embezzle the funds of the bank, or because of the additional labor it would require to make it conform to the others. At all events, the honesty and fidelity of Schardt was the fact insured; not honesty so hedged about that he could not be dishonest; not honesty compelled and *enforced* by active and sleepless vigilance; not a species of honesty or fidelity secured by an impending threat that an expert bookkeeper would supervise his books, at a greater expense to the bank than the premium paid annually for this insurance.

It is universally known that there are two modes of

inspecting the condition of a bank. The one is that made by the committee of the bank, which never goes to original entries, never adds up columns or calls in pass books, but accepts as correct reports made to it by the cashier, purporting to be taken from original entries. The other is made by expert bookkeepers, who do go to original entries, who make comparisons of the entries made in various books, and which should bear upon each other, which add up columns. The latter, too, calls in all pass books of depositors, and compares entries made in them with corresponding entries upon the individual ledger.

The representations made in the application in this case disclosed to the Guarantee Company that inspections had always been made by the finance committee, and this would be the custom in the future. And no objection was made. It is fair to infer that the Guarantee Company knew that the committees, especially the finance committee, which had charge of supervision and discounts, was made up of the largest stockholders, or persons largely interested in finances and success of the bank, and were willing to leave to it to make such inspections as their interest would dictate. The Circuit Judge, Clark, held on this point that "so long as the bank officers and the committee acted in good faith, such examinations as the appointed committee thought proper and sufficient for the protection of the bank and its stockholders, would satisfy the requirements of this contract. If anything more was wanted, it was a matter for specific agreement."

The principle announced in *American Surety Co.* v. *Pauly*, 170 U. S., 160, that "when a contract is so drawn

as to leave room for two constructions of its provisions, it must be interpreted most strongly against the party who prepared it, and delivered to the other party for his protection."

IX.

IN THE MATTER OF THE CASHIER'S BOND.

The cashier's bond constituted Exhibit A to the original bill, and is set out from pages 5 to 9 of transcript—is in the penal sum of $20,000, and is dated January 1, 1893. The annual premium of $100 was paid. This premium carried the bond to January 1, 1894.

This bond was only in existence from January 1, 1893, to April 17, 1893, when Schardt died.

The amount claimed upon this bond is $22,964.17 of principal, and $164.52 interest, aggregating $23,128.69.

Rec., 28.

This sum was taken between January 16, 1893, to death of Schardt, in April following.

The bond recites that:

"Whereas, the said employe has been appointed cashier at Nashville, Tenn., in the service of said employer, and has been required to furnish security that he shall not be guilty of any *fraudulent* act in the performance of his duties in said capacity, by which the said employer shall suffer any pecuniary loss."

Later, by recitation, the bond undertakes to limit the liability of the Guarantee Company, "to any act of fraud committed by the said employe in connection with the du-

ties of said appointment, and constituting embezzlement or larceny."

This bond contains, also, the following:

"Said company, fully relying on the truth of the statement and declaration contained in a certain document distinguished as employer's guarantee proposal No. 154,806, dated the 10th of January, 1893, and signed, Lewis T. Baxter, President, on behalf of said employer, and lodged with the said company at its office in Montreal, and in the strict performance and observance hereafter by the said employer of the contract thereby created, do hereby," etc.

Said bond also contains the following:

"Provided, always, that this bond and guarantee, hereby granted or undertaken, shall be subject and liable to the terms and conditions hereupon indorsed."

I shall notice only such terms and conditions as are supposed to be material to this lawsuit, and omit all others:

"1. Any misstatement of a material fact in the declaration within mentioned, or in any claim made under the bond, will render the bond void from the beginning.

"2. That said employer shall use all due and customary diligence in the supervision of said employe for the prevention of a default, and to that end shall cause an inspection or audit of his accounts to be made at least once in twelve months, and if the said employer shall, at any time during the currency of this bond, become aware of any act or default on the part of such employe, which would constitute a claim hereunder, and shall continue said employe in his service, without notification to the said company, the said company will not be responsible hereunder for any loss or default which may occur subsequent to said act or default of said employe.

"3. That any written answers or statements made by, or on behalf of said employer in regard to, or in connection with the conduct, duties, accounts, or methods of su-

pervision of the said employe, delivered to the company either prior to the issue of this bond, or any renewal thereof, or at any time during its currency, shall be held to be a warranty thereof, and form a basis of this guarantee, or of its continuance.

"4. That the said employe has not, to the *knowledge* of said employer, been guilty of any serious dereliction of duty or default in this, or any other service, or that his habits have been such as to incur said employer's censure previous to the issue of this bond.

"6. This bond shall extend to cover only such losses as may have been incurred by reason of the *fraud* of the said employe during the currency of this bond, and within twelve months previous to the notification to said company of any default hereunder."

The cashier's bond was issued upon what is called employer's guarantee proposal No. 154,806, and which is signed by Lewis T. Baxter. I now quote from this all the questions and answers supposed to be material to this suit, omitting all immaterial.

Rec. 89, 90.

"Ques. 3. Has he ever been in arrears or default in the bank's service, or, as far as you have heard, in any previous employment?

"Ans. No.

"Ques. 4. Have you known or heard of anything unfavorable as to his habits or associations, past or present, or of any matters concerning him about which you deem it advisable for the company to make inquiry?

"Ans. No.

"Ques. 13. When were applicant's books and accounts, including cash, securities, and vouchers (if any) last examined, and by whom?

"Ans. December 31, 1892, by finance committee (where they found correct), of bank, and found correct.

"Ques. 14. In case of applicant's handling cash or securities, how often will the same be examined and com-

pared with the books, accounts, and vouchers, and by whom?

"Ans. Not less than quarterly, and often monthly, by finance committee?

"Ques. 16. Will applicant handle funds or securities not subject to routine check or periodical examinations? If so, please describe their nature.

"Ans. No."

All the above and many other questions and answers are concluded by this general printed language:

"The above answers and representations are true to the best of my knowledge and belief." Dated January 10, 1893. Signed: "Lewis T. Baxter. Official title, President."

The assignments of error made in this court in respect to this bond are set out on page 14 of brief of defendant in error (omitting many set out in the record before the Court of Appeals but not renewed in this court), and are as follows:

1. The bank represented that it did not know of and had not heard of anything unfavorable as to his habits or associations, past or present, of the employe upon whom it was seeking the issuance of the bond, yet, at the time the bank and the particular officer making the statement for the bank, *knew* that the employe had been engaged in speculation, and had been a partner in a gambling concern while occupying a position of trust in the bank, and no effort was made to verify his statement that he had sold out his interest in the bucket shop and had ceased speculating.

2. The bank procured the issuance of the cashier's bond by representing that the books and accounts of the employe, who had been its teller for five years, had been examined and found correct to the end of his term of office; yet, at that time, the books and accounts of the bank showed a default of $73,715.44, in a bank with a capital of only $50,000.

3. The court allowed $5,992.12 of overdrafts "allowed but not authorized," as a part of the default for which the company was liable, although the bond only protected the bank against a default "constituting embezzlement or larceny."

The court perceives that this bond makes an effort to create a *warranty* in respects of all written statements or answers made by Baxter, "in regard to or in connection with the conduct, duties, accounts, or methods of supervision of said employe prior to the issue of this bond."

The superadded words that the facts are true "to the best of insured's knowledge," imply a wilful untruth to avoid the policy.

1 Biddle on Ins., sec. 562, citing
Clapp v. Mass. Benef. Asso'n, 146 Mass., 519.
United Breth., etc., v. Kinter, citing France v. Ætna Ins. Co., 94 U. S., 561; Ins. Co. v. Grivly, 100 U. S., 614, and other cases.
National Bank v. Ins. Co., 95 U. S., 673.

Applying the principles of law to the facts, we have this:

To the question:

"Has he ever been in arrears or default in the bank's service, or as far as you have heard in any previous employment?"

The answer is:

"No, to the best of my knowledge and belief."

So, with reference to the fourth question, whether he had known or heard anything unfavorable as to his "habits or associations, or any matters concerning him about which you deem it advisable for the company to make inquiry?"

The answer is:

"No, to the best of my knowledge and belief," and so on, as respects the other questions, viz.: 13th and 16th.

The proof abundantly shows that Schardt's habits and associations, as far as the community knew, were good, and that he was esteemed a model man.

Suppose Baxter had heard through an anonymous letter that Schardt had, at one time, owned stock in a brokerage association, or that he had one or more transactions in speculation. These cannot be said to constitute habits or create "associations."

Ætna Ins. Co. v. Davey, 123 U. S., 739.
3 Joyce on Ins., sec. 2076.

Bearing on this point, we must look to that condition of the bond relating to this same matter, and read it in connection with the questions and answers as quoted above. It reads: "That the said employe has not, to the knowledge or belief of said employer, been guilty of any serious dereliction of duty or default in this or any other service, or that his habits have been such as to incur employer's censure previous to the issue of this bond."

The question called for Baxter's personal "knowledge and belief." He had no *knowledge* is certain, and he said that he had no belief, "which he deemed it advisable for the company to make inquiry about." The argument is that he should, in view of the statements of the anonymous letter and what Sykes says he told him, have a belief, and that the court should hold that he did have a belief. The Guarantee Company selected Baxter as the person to answer the questions, and sought his personal belief, as they

might have selected the sheriff, or any other public man, to give it the benefit of his knowledge and belief. The correspondence is addressed to "Lewis T. Baxter, pt.. managing director Mechanics Savings Bank and Trust Co., Nashville, Tenn.," and requested such information as "*you* deem it advisable." The argument of our opponents goes upon the theory, that, by reason of all this, Baxter became, in some way, a detective for the Guarantee Company, and that it was his or the bank's duty to run down to a positive affirmation or denial, every loose rumor in respect to their employe, no matter how ignoble the source and vehicle of the information.

Representations, expectations, belief, or opinion, without fraud, do not avoid a policy.

2 Joyce on Ins., secs. 1903. 1904. and cases cited.
Beham v. United Guarantee Co., 7 Exch., 744.
21 L. J. Ex., 317.

X.

The next assignment of error on the bond of the cashier is quite a broad statement of the facts. It is:

"The bank procured the issuance of the cashier's bond by representing that the books and accounts of the employe, who had been its teller for five years, had been examined and found correct to the end of his term of office; yet, at that time the books and accounts of the bank showed a default of $73,715.44, in a bank with a capital of only $50,000."

All the foregoing is based upon question 13 and answer thereto, propounded to Baxter by the Guarantee Company, under the circumstances and qualifications stated hereinbefore:

"When was applicant's books and accounts, including cash, securities, and vouchers (if any) last examined, and by whom?

"Ans. December 31, 1892, by finance committee (where they found correct) of bank and found correct."

Rec., 90.

This answer was given under the qualification, "to the best of my knowledge and belief." The proof abundantly shows that the books and accounts had been examined December 31, 1892, by the finance committee, and found and reported correct by that committee. This complaint is directed—not to the fact, but to the mode and thoroughness of that examination. This we have presented heretofore, on the same question made in respect to the teller's bond, and to which we refer the court.

XI.

$5,992.35 OF OVERDRAFTS.

It is said that this item should not be allowed as a charge against the Guarantee Company, on the bond of the cashier. Solicitors for the company say: "This may have constituted a fraudulent act of the employe (Schardt), but it certainly cannot be either embezzlement or larceny."

We have several replies to this:

The Court of Appeals, on the last trial, disallowed the items constituting the $5,992.35, but otherwise affirmed the judgment of the Circuit Court, the Court of Appeals holding that there was no sufficient evidence that this sum was taken by Schardt, under such circumstances as

constituted either embezzlement or larceny. To this complainant filed the following exceptions upon the record:

THE GUARANTEE COMPANY OF NORTH AMERICA *v.* THE MECHANICS' SAVINGS BANK AND TRUST COMPANY.

For the use of J. J. Pryor, Assignee.

The plaintiff, the Mechanics' Savings Bank and Trust Company, by its attorney, Edward H. East, comes on this the nineteenth day of January, 1901, and assigns error, and says that on the record and proceedings in the above entitled cause there is error in this, to wit:

I.

The Court of Appeals for the Sixth Circuit committed error in allowing the defendant credit for $5,992.35, on his bond as cashier, the proof showing that this sum was a part of his defalcation, under the terms of said bond.

II.

The court erred in not finding and holding from the proof, and upon a full construction of the bond, that the default of Schardt, accomplished by embezzlements, under the bond as cashier, was $22,964.17, committed during the currency of said bond, viz.: between January 1, 1893, and April 17, 1893.

EDWARD H. EAST,

Solicitor for Complainant.

First. Every item of embezzlement and larceny making up the large sum reported by the experts, was set out in what is known in the record as Exhibit X to the bill, and was a part thereof. Said Exhibit X only purports to show the *embezzlements and larcenies* of the cashier and teller. It makes no effort to exhibit any item that had been honestly dealt with, as shown by the books. Said exhibit occupies about six pages of closely printed figures in the record. (See Rec., pages 13 to 18, inclusive), and includes probably a little less than eight hundred items of money, varying in amounts. It took the experts some seven months to go through the books of the bank and cull out these dishonest items from the great mass of honest transactions.

An inspection of the exhibit shows that the experts set out the date of the dishonest transaction, the amount thereof, how it was accomplished; in brief, citing the book and page where and on which the item could be found. This exhibit was made a part of the bill. I will state just here that the Guarantee Company had been asked to put in an expert bookkeeper to assist in making out the exhibit, and declined to do so. Also the widow and administrator of Schardt had been likewise requested, and had done so.

This Exhibit X shows the default of Schardt, as cashier, to be $22,817.30, of which said item of $5,992.35 constituted a part. This Exhibit X constituted the proof of loss made to the Guarantee Company.

The following is the language of the bill:

"Complainant now charges that said Schardt, as such cashier, and during the currency of said bond, did, as

shown by the report of said expert accountants and bookkeepers, and did, in fact, by acts of fraud committed by him in connection with the duties of his said office, and constituting embezzlement or larceny, take of said bank and appropriate to his own use, the sum of $22,817.30, without interest, and for which complainant is entitled to reimbursement under the terms and conditions of said bond."

The bill then proceeds to state that it did give notice, "and make the proof of the facts to said Guarantee Company."

While this Exhibit X was filed in court as a part of the bill, and a copy thereof in the hands of the Guarantee Company, and its solicitors, it filed its answer, stating as follows:

"Respondent admits that after said bank made its assignment to said Pryor, its affairs were examined, and it was discovered that said Schardt had *abstracted* from said bank a large amount of its money, a part of which was *abstracted* in the year 1890, a part in 1891, part in 1892, and a part in 1893, but the respondent does not admit that the amounts *embezzled* in each year are correctly stated in the bill," thus showing that defendant knew that every item of Exhibit X was charged as embezzlement.

The answer does not raise any issue on any item in said exhibit, or make the point now made, that the taking did not amount to an *embezzlement* or *larceny*. With the exhibit before defendant, the question should have been raised either in the answer, or certainly in the examination of witnesses, who testified to the correctness of the items in said exhibit, as embezzlement or larcenies.

It is evident to the court that exhibit X was the basis for the examination of the expert witnesses, and that it was not necessary to ask these witnesses if Shardt had embezzled or stolen such items *eo nomine*. The witnesses, the parties, and the attorneys went upon the theory that this exhibit contained the entire claim of complainant, and that each item was embezzlement or larceny. The experts headed the exhibit with these words: "Statement of shortage of John Schardt, cashier and teller of the Mechanics' Savings Bank & Trust Co."

The examination of the witnesses who made this exhibit, both original and cross, proceed upon the theory that "shortage" meant embezzlement or larcenies. Sometimes the word "defaulter" is used. I give samples of the original and cross-examination:

Ques. 4, of McEwin. Witness was asked with reference to each and every one of the several hundred items of said exhibit: "Please state what was the character of these defaults, and of what did they consist as respects detention?

"Ans. They were extractions from the funds of the bank, made by Schardt, and were evidenced by the books kept by him, and covered on the books kept by him from detection.

"Ques. 5. Please state whether these abstractions or embezzlements were easily or readily detectible? etc.

"Ques. 7. How long were the bookkeepers and you engaged in ascertaining these abstractions?

"Ques. 9. In order to ascertain the facts of embezzlement of the funds of the bank? etc.

"Ques. 12. Please state whether the amounts, as stated above by you, were taken from the funds of the bank?

"Ans. These amounts mentioned were abstracted by John Schardt, etc."

On the cross-examination of this witness, the attorney for the company, Mr. Granbery, proceeding upon the idea that every item in Exhibit X was an embezzlement or larceny:

"Cross question 15. Please furnish statement marked Exhibit 4, showing in detail the amount embezzled in each particular year, and each method."

The witness did so. It is alone in this Exhibit 4 that the aggregate of embezzlements, viz.: $5,992.35, done by means of overdrafts, first appears.

Rec p. 39

In Exhibit X each item of embezzlement is set out, but this does not, in every instance, show how it was done. Our friends on the other side wanted an exhibit showing, in brief, the amounts embezzled in each particular year, and the method by which each was accomplished. In this he was accommodated, said exhibits showing the amount of embezzlements each year, and the method by which it was done, such as "failure to credit deposit," "manipulating individual deposit," "failure to credit notes collected," "failure to enter deposit," etc., and then the items of $5,992.35, and the method by which it was done is stated to be "overdrafts allowed and not authorized." Our opponent's question called for embezzlement, and the method by which it was accomplished. Now he seizes upon the method set out in the answer to show that it was not an embezzlement, but was money obtained in some mode discreditable, or otherwise, not amounting to an embezzlement.

I refer the court to the questions and answers of Professor Jennings, who helped make out Exhibit X, and who, in response to the question, what was the result of the examination, said:

"I examined the books from September 9, 1890, to April, 1893, finding John Schardt's shortage during that time as teller and cashier, including interest, to be $107,182.12." He then sets out the amount for each year, and adds: "As cashier from January 1, 1893, to April 17, 1893, $22,964.17, and this item of $5,992.35 is included to make that sum."

Jennings stated the shortage of Schardt, as cashier, to be $22,964.17. He was then asked question 4:

"From whom had the money been taken or abstracted?

"Ans. From complainant bank.

"Ques. 5. Was the fact shown by books kept by Schardt, or which were under his care and keeping?

"Ans. Yes.

"Ques. 6. Was it shown to be money taken, or other valuables?

"Ans. As money taken.

"Ques. 7. How was Schardt shown to be connected with the embezzlement?

"Ans. The manipulations on the books were all shown to be in his handwriting."

The record abundantly shows that the whole testimony was taken upon the theory that Exhibit X showed only items of embezzlement or larceny.

On the trial and in the argument before the Circuit Judge (Clark), no such point was made, as the opinion reported in 68 Fed. Rep. shows. After Judge Clark had decided the case, and directed judgment to be entered for

complainant, and the decree was prepared and submitted to the court, on July 1, 1895, the attorney for the company for the first time called the attention of the court to this item, pointing out the present objection by error which he assigned August 1, 1895.

Neither the bill nor the testimony made effort to hold Schardt or the company liable for "overdrafts" as such, but only for embezzlements or larcenies, but if Schardt made an overdraft on the bank in the name and behalf of another party, and without the knowledge of such party, or the bank, and himself took the proceeds and used them, it would be larceny or embezzlement on the part of Schardt, and the fact that it was called an "overdraft" by the experts would not make it a legitimate transaction, or deprive the transaction of its felonious character. Especially would this be true when the experts were asked to state the *amount embezzled*, and the method used by the *embezzler*.

The question concludes the particular criminality as that of embezzlement, and shows that the method by which it was accomplished was by overdraft.

This point was not made before the trial judge, and it was too late to assign it as error in the Court of Appeals or in this court.

Danforth Dig., Vol. I, p. 1047, where all the cases are collected.
Marine Bank v. Fulton, 2 Wall., 252.

It is too late to present the question for the first time on a motion for a new trial.

Reagin v. Aiken, 138 U. S., 110.
Pacific Express Co. v. Malen, 132 U. S., 531.

We insist that under the rules of interpretation governng contracts of this character, that the bank would have the right of recovery for this item of $5,992.35, because of the ambiguity of the bond in its entirety, and that the Guarantee Company cannot insist that the act of fraud must amount to a technical "embezzlement" or "larceny."

The bond declares: "Whereas, the said employe has been appointed cashier at Nashville, Tenn., in the service of said employer, and has been required to furnish security that he shall not be guilty of any fraudulent act in the performance of his duties in the said capacity, by which the said employer shall suffer pecuniary loss; and, whereas," etc. Later, and after many recitations in which the mind of the reader, especially a layman, would have lost the connection, it says, it covenants "to reimburse unto said employer, or his or their representative or assigns, the amount of any loss, not exceeding in the whole the sum of twenty thousand dollars, which, during the currency of this bond, shall be sustained by the said employer by reason of any act of fraud committed by the said employe in connection with the duties of said appointment, and constituting embezzlement or larceny."

The sixth condition provides:

"This bond shall extend to cover only such losses as may have been incurred by reason of the fraud of the said employe during the currency and within twelve months previous to the notification to the said company of any default hereunder."

It is no answer to say, that, while the bond is ambigu-

ous in respect to what acts the Guarantee Company will be liable for, in one place saying, "fraudulent acts, etc., by which the said employer shall suffer pecuniary loss;" at another place saying, "any acts of fraud, etc., constituting embezzlement or larceny," and at another place saying: "This bond shall extend to cover only such loss as may have been incurred by reason of the fraud of the said employe during the currency of this bond, and within twelve months," etc.

It will doubtless be replied to this that the first relates to the scope and obligations which the Guarantee Company is about to assume; that the next insertion relates to what it actually contracts to do, and that the third and last is a condition on the back of the bond relating to a limitation. It will not be denied, however, that the bond as a whole is ambiguous on this point, when read by the public generally, for whom it was intended.

This court has uniformly held:

"If looking at all its provisions, the bond is fairly and reasonably susceptible of two constructions, one favorable to the bank and the other favorable to the surety company, the former, if consistent with the objects for which the bond is given, must be adopted, and for the reason that the instrument which the court is invited to interpret, was drawn by the attorneys, officers, or agents of the surety company."

American Surety Co. v. Pauly, 170 U. S., 133.
Imperial Fire Ins. Co. v. Core, 151 U. S., 452.

This bond more than once professes and pretends to secure the bank against loss by reason of the "fraud" and "fraudulent acts" of the employe, without regard to the technical criminal offense committed, and the public asked

to accept it. The public have little or no concern, and less knowledge, of what constitutes the elements of larceny, embezzlement, or fraudulent breaches of trust, or kindred crimes which go to make up the criminal laws of the country. The public wants indemnity against the wrongful and fraudulent appropriation and taking of money by parties intrusted, necessarily, with its custody and handling, as clerks, officers, etc., and to meet this want these bonds are made, accepted, paid for, and relied upon, and to this end they should be construed, unless there is a clear, unambiguous, and positive interdiction not reached by ingenious construction, but by the necessity of the very words used.

If the one part of the contract contradicts another part, then interpret the whole contract by the general purpose for which the contract has been made and entered into.

The court will notice that both bonds were issued upon printed representations made to the company, and signed in both cases by third persons, who are not parties to this suit, and have no interest herein, viz., Peden and Baxter, and that each of which is a separate and distinct paper from the bond or policy issued. These representations were made in answer to printed questions submitted to them. As respects the bond upon "teller and collector," there is no effort made to make the answers warranties, or the truth of the answer condition precedent to a recovery, the only condition precedent in this bond is "the actual payment of the premium, and its acceptance."

The only other language by which it is undertaken to *unite* the representations with the bond or policy is as follows: "And, whereas, the employe has delivered to the

company a certain statement, and it being agreed and understood that such statement constitutes an essential part of the contract hereinafter expressed." In *Phœnix Ins. Co.* v. *Readdin*, 120 U. S., 1, the policy contained the following: The answer to printed questions was referred to as "the declarations or statements upon the faith of which this policy is issued," and, in the concluding paragraph of the application, the answers are declared to be "fair and true answers to the foregoing questions," and to "form the basis of the contract of insurance." The court held them to be not warranties, but declarations and collateral.

Clearly, the bond or policy issued on the teller and collector contains no warranty by its words or construction.

The other policy or bond on the cashier does make an effort to create a limited warranty in respect to certain things mentioned therein—such as "conduct," "duties," accounts, or methods of supervision—but its fatal defects in these particulars are: (1) It is signed by a third party, Baxter; (2) "on information and belief of Baxter."

Gage v. Lewis, 68 Ill., 604.
Towle v. Society, etc., 3 Gifford, 42.
Benham v. Assurance Co., 7 Welsb. H. & G., 744.

As respect the bond or policy covering the office of cashier, an effort is made to unite the two papers, and also to create a limited warranty, as follows:

"Now, therefore, this bond witnesseth, that the said employe, for and on his own behalf, and the said company, fully relying on the truth of the statement and declaration contained in a certain document, distinguished as employers' guarantee proposal No. 154,806, dated 11th

day of January, 1893, and signed by Lewis T. Baxter, president, on behalf of the said employer, and lodged with the said company at its office in Montreal, and on the strict performance and observance hereafter, by the said employer, of the contract thereby created, do hereby severally and jointly covenant," etc.

"That any written answers or statements made by or on behalf of said employer, in regard to or in connection with the *conduct*, *duties*, *accounts*, or *methods* of supervision employe delivered to the company, either prior to the issue of this bond or any renewal thereof, or at any time during its currency, shall be held to be a warranty thereof, and form a basis of this guarantee or of its continuance."

The most that can be claimed under this is, that the answers, to be warranties, must apply to the *conduct*, *duties*, *accounts*, or *methods of supervision* of said employe. We deny that there has been a breach of said warranty in respect to either. This brings us to the answers of Baxter, in these respects. No one, we insist, is untrue, or constitutes a breach of warranty. It is to be remembered that every answer which Baxter gave was made under these written conditions: "The above answers and representations are true, *to the best of my knowledge and belief*." There can be no warranty when a statement is thus qualified.

There are no questions asked that specifically apply to each of the foregoing.

I submit what question applies to the "*conduct*" of Schardt specifically? It will not be said that the answer was untrue as respects the "duties." His duty was that of *cashier*. What under the head of "accounts?" The only question asked in reference to his accounts, was,

When were his accounts last examined? How often would the cash or securities handled by Schardt be compared with the books, accounts, and vouchers?

No answers were given to questions 5, 15, and 19, and were waived. Question 5 was, whether he was pecuniarily embarrassed or insolvent, or indebted to the bank. Fifteen was, In case of applicant acting as teller will he be required to balance his cash daily and report the same to the president or cashier, and will a record of the same be kept? 19. At what date was the bank last examined by a national or state official, and was the result satisfactory to the department? The answer to these three questions was waived (see *Phœnix Mutual Life* v. *Madden*, 120 U. S. Rep.), and none was made.

It may be said that untrue answers were made to the following questions:

3. Has he ever been in arrears or default in the bank's service, or, as far as you have heard, in any previous employment? The answer was, "No," to the best of my knowledge or belief.

2. Have you *known* or heard anything unfavorable as to his *habits* or *associations*, past or present? Answer, "No," to the best of my knowledge or belief.

These last two questions are indefinitely broad, and might cover anything or nothing by construction. It is clear that neither had reference to any indebtedness of Schardt to the bank, either by previous default as teller or otherwise, for the reason later the company asked specifically about these—and waived the answer. (See question 5.)

In the case of *Fisher* v. *Crescent Ins. Co.*, 33 Fed. Rep., 549, the covenant of the applicant in the application was as follows:

"That the foregoing is a just, true, and full exposition of all the facts and circumstances in regard to the condition, situation, and value of the property to be insured, *so far as same* are known to applicant, and the same is hereby made a *condition* and a *warranty* on the part of insured."

The court held that the words, "*so far as the same are known to the applicant*" reduced or lowered what otherwise would have been a warranty to a representation, which could not be recovered upon in the absence of fraud.

See also,

Wilkins v. Ins. Co., 57 Ia., 539 (10 N. W. Rep., 916).
Redman v. Ins. Co., 47 Wis., 89 (1 N. W. Rep., 363).
Ins. Co. v. Fisher, 30 Fed. Rep., 662.
Bank v. Ins. Co., 95 U. S., 673.
Moulor v. American Ins. Co., 11 U. S., 335.

EDWARD H. EAST,
Solicitor for Bank.

APPENDIX.

VARIOUS ACTS OF THE LEGISLATURE OF TENNESSEE LICENSING DEALINGS IN FUTURES.

ACTS OF 1883, CH. 105, 106, APPROVED MARCH 30, 1883, PP. 103–128.

Dealings in futures was made a privilege. Also by the Act of 1885, Ch. 1, p. 1.

ACTS OF 1887 (pamphlet act), CH. 1, P. 13.

After naming the various and different occupations licensed, it says:

"FUTURES.

"Each person, firm, company, or corporation dealing therein, and each branch or agency of such firm, company, or corporation, per annum, $1,000."

ACTS OF 1889, CH. 130, P. 247.

"FUTURES.

"Dealers in futures, and brokers dealing in futures, whether actual delivery is intended or not, each person, firm, company, or corporation dealing or doing a brokerage association therein, and each branch or agency of such company or corporation, in cities, taxing districts, or towns of thirty thousand inhabitants or over, per annum, $1,000."

This act then grades the amount of the license, according to population, of all towns under thirty thousand.

ACTS OF 1891, CH. 25, P. 50.

This act is the same as the Act of 1889, set out above.

Acts of 1893, Ch. 89, p. 131.

This act is the same as the Act of 1889, Ch. 130, set out above.

There is a proviso to this act to the effect that it shall not be construed to amend, repeal, or modify the criminal laws of the State. Approved April 30, 1893.

These and similar acts of the Legislature were construed by the Supreme Court, in *State* v. *Duncan*, 16 Lea, 79, 80, holding the license valid.

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THE GUARANTEE COMPANY OF NORTH AMERICA

v.

THE MECHANICS' SAVINGS BANK AND TRUST COMPANY,

FOR THE USE OF J. J. PRYOR, ASSIGNEE.

The plaintiff, the Mechanics' Savings Bank and Trust Company, by its attorney, Edward H. East, comes on this the nineteenth day of January, 1901, and assigns error, and says that on the record and proceedings in the above entitled cause there is error in this, to wit:

I.

The Court of Appeals for the Sixth Circuit committed error in allowing the defendant credit for $5,992.35, on his bond as Cashier, the proof showing that this sum was a part of his defalcation, under the terms of said bond.

II.

The Court erred in not finding and holding from the proof, and upon a full construction of the bond, that the default of Schardt, accomplished by embezzlements, under the bond as Cashier, was $22,964.17, committed during the currency of said bond, viz.: between January 1, 1893, and April 17, 1893.

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No. 617.

No. 792.

United States Circuit Court of Appeals.

SIXTH CIRCUIT.

The Guarantee Co. of North America

VS.

Mechanics Savings Bank and Trust Co., to use of James Pryor, Assignee.

In Error to Circuit Court of Appeals for the Sixth Circuit.

BRIEF OF

EDWARD H. EAST,

SOLICITOR FOR DEFENDANT IN ERROR.

MARSHALL & BRUCE CO., NASHVILLE, TENN.

Ten copies Letter sent by Mr. East
+ distributed to Court.

United States Circuit Court of Appeals

FOR SIXTH CIRCUIT.

Guarantee Company of North America,
Plaintiff in error,

v.

Mechanics' Savings Bank & Trust Co., for use, etc.,
Defendant in error.

STATEMENT OF CASE.

May it please the Court:

This appeal is taken from the Circuit Court of the United States for the Middle District of Tennessee, to review a decree of that court, in favor of J. J. Pryor, assignee of the Mechanics' Savings Bank & Trust Company, against the Guarantee Company of North America, a Canadian corporation, for the amount of two bonds, executed by the Guarantee Company, guaranteeing the bank against loss by dishonesty of its teller, John Schardt, and the same person as its cashier, he having filled the two positions in succession.

The opinion of Circuit Judge Clark can be found in 68 Fed. Rep., 459.

The opinion of the court affirming Clark can be found in 80 Fed. Rep., 766.

The opinion for a rehearing in 82 Fed. Rep., 345.

The opinion of the Supreme Court can be found in 173 U. S., 387.

IN RE OF TELLER'S AND COLLECTOR'S BOND.

The teller's bond is dated January 16th, 1888, and was renewed from year to year until January 1, 1893. This bond was in the penal sum of $10,000, for which the bank paid $100, and, to effect a continuation of said bond for ensuing years, a like consideration was to be paid by the bank annually, which was done, and the bond was continued current until the 16th day of January, 1893:

The condition of the bond is:

"To make good and reimburse to the employer such pecuniary loss as the employer shall have sustained by the *fraudulent* acts of the employe, in connection with the duties of said office or position, or with any other duties assigned to him by the employer in the said service, committed by him, and discovered during the continuance of this bond, and within six months from the employe ceasing to be in said service."

Rec. 11–15.

There are many conditions and provisions attached to this bond, and agreed to be observed, not necessary to notice in this litigation. I here quote such only as it is insisted are necessary to the adjudication of this case, and are agreed to be "observed and binding as a part of this bond:"

"That this bond is *issued* and *renewed* on the express understanding that the employe has not, within the knowledge of the said employer, at any former period, either in this or other employment, been guilty of any default or serious dereliction of duty.

"That the employer shall observe, or cause to be observed, all due and customary supervision over the said employe for the prevention of default, and if employer shall, at any time during the currency of this bond, condone any act or default on the part of the employe which would give the employer the right to claim hereunder, and shall continue the employe in his service, without notification to the company, the said company will not be responsible hereunder for any default which may occur *subsequent* to said act or default of said employe so condoned.

"That the employer shall at once notify the company, on his becoming aware of the said employe being engaged in speculation or gambling, or indulging in any disreputable or unlawful habits or pursuits.

"That there shall be *an inspection* or audit of accounts or books of the employe on behalf of the employer at least once in every twelve months from date of this bond."

The bond also declares in its preamble the following:

"And, whereas, the employer has delivered to the company a certain statement, and it being agreed and understood that such statement constitutes an essential part of the contract hereinafter expressed."

This statement is nowhere identified or more definitely pointed out. It is a separate and distinct paper from the bond.

The guarantee company contends that the paper referred to is the one signed by C. W. Peden, the then cashier of the bank, as this was the only paper delivered to the company either before or contemporaneously with the execution of the bond, and which consists of questions and answers.

On this theory, I now quote from it such questions and answers as are supposed to enter into this lawsuit:

Question 8. What is your custom in regard to frequency of *inspection?* Are they at stated periods or irregular, and what is the longest time allowed to elapse between inspections?

Answer. Every quarter.

Question 9. Has the bank a duly appointed and authorized inspector or inspectors? If not, by whom are the inspections made?

Answer. The finance committee.

Question 18. In the event the employe filling the post of teller, how often, and by what officer will the teller's cash be checked and counted?

Answer. By finance committee quarterly.

Rec. 105–6.

The questions and answers are concluded by this declaration:

"I hereby declare that the answers and representations above made are true, and that I am not aware of any matter or thing

affecting the character or reputation of the applicant which should create any doubt as to his reliability or trustworthiness.

"Dated at Nashville, Tenn., this 21st day of January, 1888.

"(Signature) C. W. PEDEN,
Cashier, on behalf of bank."

Rec. 106.

There is no effort in this bond to make these answers and declarations warranties. There are no warranties in this bond.

The teller's bond was renewed from year to year by the payment of the $100 by the bank, and without any specific questions or answers additional, but before the bond was renewed each year, the defendant company sent out to its patrons a printed circular, in which, among other things, was the following:

"It is necessary, before the bond can be renewed, that you obtain the certificate on the back hereof, by your president or cashier, and on its return with remittance of the premium, the renewal can be immediately effected."

Stipulation, Rec. 103.

The certificate on the back was filled up and signed by the *cashier*, and among other things, it stated that the accounts of said teller, Schardt, had been *examined* and *verified* by the finance committee of said bank, and the bond was not renewed any year until this certificate had been made out and delivered to the defendant company.

Rec. 106.

This statement only applied to the teller's bond.

The embezzlements as teller and collector commenced September 12, 1890, and continued during the currency of the several bonds, successively, to January 1, 1893, when Schardt became cashier, vice Sykes, resigned.

The embezzlements, as shown by the experts, are subdivided, as follows:

From Sept. 1, 1890, to Jan. 16, 1891	$ 5,879 34
From Jan. 16, 1891, to Jan. 1, 1892	22,290 00
From Jan. 1, 1892, to Jan. 1, 1893	50,649 90
Total (record, 33)	$77,819 24

HOW EMBEZZLEMENTS WERE COVERED ON THE BOOKS.

These various embezzlements were covered on the books of the bank, and detection prevented:

1. By false additions.
2. Failure to enter notes discounted.
3. Failure to enter money collected.
4. Failure to give proper credits to depositors on the books of the bank.
5. Failure to credit on the books of the bank interest paid on notes.

Rec. p. 34, q. 4; Rec. 48, q. 10.

Nearly all of the embezzlements were covered on the books by misstating the amount due depositors upon the books kept by Schardt.

Rec. 38, q. 14; q. 39, q. 33.

The expert, McEwen, and others, when asked if these abstractions and embezzlements were easily detectable from the books of the bank, testified:

"They could have easily been detected by an expert bookkeeper. His falsifying of the books was done, in main, in false additions on the cash book, and whenever this was done he nearly always falsified the general account of individual depositors on his general ledger, to correspond with the errors made on the cash book. A few of his false additions on his cash book were covered up by falsifying one or more of his other accounts on his general ledger. The amount shown as due individual depositors by the account on the general ledger, was far less than that actually shown to be due by the pass books of depositors."

Rec. 34, q. 5.

The two expert bookkeepers (McEwen and Jennings), with their assistants (Fisher and Northern), were engaged in this work "several months."

Rec. 34, q. 7.

It was necessary to refer to various and different books. (Rec. 34, ques. 9.) All pass books had to be called in. (Rec. 34, ques. 10.) In some instances no deposit tickets could be found.

Rec. 35, q. 11.

BOOKS KEPT BY THE BANK (Rec. 35, ques. 4).

1. Individual ledger, kept by a clerk.
2. General ledger, kept by Schardt until made cashier.
3. Cash book, kept by Schardt until made cashier.
4. Daily balance book, kept by Schardt until made cashier.

Pryor gives the books kept by the bank, as follows: General ledger, individual ledger, cash book, deposit register, check register, discount register, and such auxiliary books as experience showed to be necessary.

The individual ledger showed the deposit account of each individual depositor.

General ledger shows every account in the bank except that of individual depositors, viz.: Demand loans, discounts, bonds, stocks, and such. It has also an account showing in totals the deposit made and checked out each day by individual depositors. This book was kept by Schardt from beyond 1890 to the time the bank closed (April 17, 1893).

The cash book shows the same things as the general ledger, except that instead of putting the business of each day under various accounts, they are grouped together on one page in

the cash book, and shows at a glance the entire business transacted by the bank during the day.

This witness testified that the fact that Schardt was permitted to keep the general ledger and act as general bookkeeper in the bank, greatly increased his facilities for embezzling the funds of the bank. (Rec. 38, ques. 16.) Also, he was asked: "Would it have been possible for Schardt to have embezzled funds of the bank to any extent without detection if he had not been permitted to keep the general ledger?" The answer is: "It would not have been possible for him to embezzle the funds in the maner he did if he had not been permitted to keep the general ledger and balance book." (Rec. 39, ques. 20).

It will be observed that what is designated herein as the teller's bond, was given upon the idea that Schardt had been assigned to the office or position of teller and collector, and covers any pecuniary loss which the bank shall sustain in connection with the duties of the said office or position, or with any other duties assigned him by the employer in said service.

This witness was asked concerning a trial balance book, said: "I saw a book of that character when I went in there, but it was incomplete, the balances not entered up, and I paid no attention to it, and I do not know for what years they were taken off." (Rec. 39, ques. 21.)

This trial balance book was left off in 1890 by the orders of Schardt. (Rec. 75, Boensch Dep., ques. 6; ques. 15.)

In the examination of these witnesses, many hypothetical questions were put by the defendant as to how, and whether these embezzlements might have been easily detected had the officers of the bank suspected Schardt, and resorted to them, all of which resulted in negative answers, except as follows: One expert said: "They could, upon any day, at close of business, have taken the daily balance book showing a record of

the condition of the bank at the time, and counted the notes on hand, bills receivable, bonds and stocks, and cash, and could then have verified the amount appearing to be upon deposit in other banks to the credit of complainant bank, and this would have only left to be verified the amount shown to be due depositors, and the way to verify this would have been to have taken from the individual ledger a trial balance, which would have shown the amount due depositors by the bank, and if this had agreed with the amount appearing upon the daily balance book to be due depositors, the officials of the bank would have verified his accounts as clearly as possible." (Rec. 38, ques. 12.) This, he said, should not, in a bank of that size, have taken over twelve hours. (Rec. 38, ques. 13.)

The other expert (Jennings), said: "No person not an expert bookkeper could have found many of those manipulations, but it would not have been difficult for any one who could add columns to have seen some of these false additions, which would have resulted in causing suspicion that some wrong was intended."

Rec. 49, q. 11.

Jennings also testified in respect to the time it would have taken: "Of course it depends upon the rapidity of the work of the bookkeeper. I should think twenty-four to thirty-six hours would be sufficient for an average bookkeeper to do that work." (Rec. 50, ques. 9.)

BY-LAWS OF BANK AS TO DUTIES OF TELLER AS BOOKKEEPER.

"The teller shall also be the general bookkeeper of the bank."

The evidence shows that no system of bookkeeping will detect or prevent embezzlements, including trial balances, and that it is not possible to ascertain the financial condition of a

bank without stopping the bank for a time, call in all the pass books, and have an expert go through the whole thing.

Rec. 73, dep. of A. W. Harris.
Rec. 85, dep. of Duncan, q. 33.

The evidence shows that in small banks it is customary for the teller to keep general ledger.

Rec. 82, q. 5, et seq.: Rec. 85, q. 27.

It cannot be contended, in view of this contract, that it was wrong to allow Schardt to keep the book known as general ledger, and that guarantee company can say successfully that this enabled Schardt to commit and conceal his embezzlements. The contract prepared by the guarantee company, and submitted to the bank, is "to make good and reimburse to the employer such pecuniary loss as the employer shall have sustained by the fraudulent acts of the employe in connection with the duties of his said office or position, or with any other duties assigned to him by the employer in the said service."

The proof shows that it is not customary for financial committees, in examinations, to go through original entries on the books, but it is customary for them to accept statements made by cashiers, officers, and clerks.

Duncan dep., Rec. 85, q. 31.
McLaughlin dep., Rec. 82, cross question 2.
A. W. Harris dep., Rec. 73, qq. 3, 4.

There was, at all times, a financial committee consisting of five members; generally three acted.

The evidence shows conclusively that the finance committee made quarterly examinations into the bank's condition, and also semiannual examinations. The main purpose of the latter was to ascertain the ability of the bank to pay a dividend. The mode and extent of these examinations are stated dif-

ferently, but substantially concur. Eatherly says: "Mr. Schardt made out a list of assets of the bank, and that list was taken charge of, generally by myself and a portion of the finance committee. We went to where the securities were kept, and took them to the directors' room, or rear part of the bank, and compared them with the amounts given on the list, to see whether they corresponded. We examined the collateral, or evidences of them, to see if they were there. We counted the cash on hand, and had generally a certificate from the banks where we deposited, to the amounts in those. We then compared the footings with the amount as shown on the daily balance sheet or balance book, to see whether they agreed with them. We found no discrepancies except in cash on hand in a few instances. Generally, there was a discrepancy of a few dollars between the money on hand and the amount shown by the daily balance sheet. Sometimes it was a deficit and sometimes a gain, but generally a deficit." (McEwen's Dep., 90–94.)

This custom was habitual and continuous.

In addition to these quarterly examinations, annual reports were submitted to the directors by the cashier. The president, or some one or more of the directors was present in the bank at all times.

Eatherly admitted that had the finance committee procured from the individual bookkeeper the total amounts shown by his books to be due individual depositors, and compared it with the amount shown by the daily balance book kept by Schardt to be due individual depositors, it would have disclosed the fact that something was wrong with books.

McEwen testified in respect to these quarterly examinations as follows:

"We counted all the money, or things that represented money, such as cash tickets, checks on other banks, deposits in other banks, and compared this with the statements furnished us by the cashier or teller. Then we took possession of all notes, bills, time or demand loans, or other paper showing an indebtedness to the bank, as well as collaterals, and did our best to ascertain the condition of the paper, and value of collaterals. We compared this with statements furnished by the cashier or teller of what should be in the bank of those kinds of paper, and also compared it with the daily balance book. As we had seen all notes or bills which had been discounted by the bank, and these had been entered on the daily balance book, we would sometimes go back to it. We always took the cashier's or teller's written statement of the deposit account. We hardly ever examined original entries of deposits, but accepted this statement as making a full and fair exhibit of these. We could not have examined original entries. There were several hundred depositors, and a great many small accounts with individuals. It would have taken all our time to have done this, and but few, if any of us, were bookkeepers or accountants. We had to rely upon the honesty of the cashier for this. We did our best to ascertain the exact condition of the bank at the end of each quarter. The finance committee was the discount committee, and all paper approved by the committee was recognized by the committee at the quarterly examination. If we did not remember it, we appealed to this book of original entries on the ticket. The quarterly examinations were of the same kind and character which all the banks of Nashville made, as we understood."

Rec. 92, q. 17.

"Every July and January of each year the directors and finance committee made an examination into the affairs of the bank with a view to ascertaining the ability of the bank to pay a dividend. These examinations of the directors and finance committee were as thorough as we could make them."

Rec. 93, q. 23.
J. B. Richardson dep., Rec. 94.
Rec. 90, q. 3.

The defendant company had a general agent (Cooley) resident in Nashville. It is a part of the duties of this general agent to gather information concerning applicants for bonds, and about persons already bonded in defendant company, and to transmit such information to the home office. To this end

the agent employed detectives at discretion, and took information from outside parties.

ASSIGNMENTS OF ERRORS AS RESPECTS THE TELLER'S BOND, AND REPLIES THERETO.

The first assignment is—

"*The bank agreed to immediately notify the company on becoming aware of the employe being engaged in speculation, and the bank learned that the employe had not only been speculating, but had been part owner in a gambling concern, and neither investigated the matter on its own account, nor notified the company.*"

The above assignment is based upon the following condition in the bond:

"That the *employer* shall at once notify the company on *his* becoming aware of the said employe *being engaged* in speculation or gambling, or indulging in any disreputable or unlawful pursuits."

1. This section involves no active duty upon the bank, or its officers or agents to ascertain what Schardt did in respect to these several matters, and only required it to *notify* the company, "on his becoming aware" that he was "being engaged," etc. No character of diligence is put upon the bank. On the contrary, the insurance company, in the language of Chief Justice Lumpkins, of Georgia, "invited the bank to repose in peace, for it guaranteed that Schardt was honest and would remain honest and faithful." Fidelity & Casualty Co. v. Gate City National Bank, 33 L. R. A., 821.

2. The evidence on this point is presented by only two witnesses. Eatherly, a director in the bank, and Sykes, its cashier. Eatherly's testimony is substantially that John Woodward brought an anonymous letter to the bank, and showed it to me, and I asked permission to call Mr. Schardt up and show it to

him. In this letter it was stated that Schardt was a partner in a bucket shop. Schardt read the letter, and said, "it was a lie, and I can prove it." Eatherly reported the letter to Baxter, the president, telling Schardt that it devolved upon him to prove it false. Schardt requested them to remain where they were. Schardt went out and got Frank Searight and Dr. Barry. These two men said that some time *before that* Shardt, Barry, and Searight had agreed to open a brokerage association. Each one was to put in a small amount—$200. Mr. Schardt, in a short time, became dissatisfied and sold his interest to Frank Searight at a small loss. (Rec. 61.)

There is no evidence in this that the brokerage association had a single transaction of any character at any time, and especially while Schardt remained in it.

3. This evidence does not show that a brokerage association was ever, in fact, opened, or did any business, only that they had *agreed to open* such association.

4. This witness locates the time of this anonymous letter as "just prior to the resignation of Judge Woodward" as a director. Woodward's resignation is dated February 17, 1893, and was accepted March 25, 1893. The bond of Schardt, as teller, had expired January, 1893, and none of these transactions relate to the time during which the teller's bond, sued on, was in force, and whatever notice this anonymous letter, or transaction, may have given, was after the bond had expired.

5. Give the whole transaction—the letter—and all that occurred, full credence, and it amounts to this: that Schardt and two others agreed to take stock to the amount of $200 each in a brokerage association, which the evidence failed to show was ever organized, or had a single transaction.

6. Brokerage associations neither buy or sell for themselves, but buy and sell on commissions for others, who do the specula-

ting and gambling, on the boards of exchange in distant cities and States where it may be lawful to do so.

7. Brokerage associations were licensed in the State of Tennessee to deal in futures at the time of these alleged transactions.

See appendix to this brief of the Acts of the Legislature, and the construction thereof by Tennessee Supreme Court, 16 Pickle, 79, holding the license to be valid.

8. Proof that a person was a stockholder in an active and going brokerage association would not necessarily prove that he was gambling or speculating or indulging in any disreputable or unlawful habits.

Scott v. National Bank, 72 Pa. St., 471.

9. The next witness called on this point was Charles Sykes. This witness was the cashier of the bank from December, 1889, to January 1. 1893, and had recommended Schardt to the directors to be his successor in that office when he retired in January, 1893, and upon this Schardt was elected and did take the office at that time. Sykes had been (as a cashier always is) the chief manager of the bank for three years, with full supervision over Schardt and the books kept by Schardt. Sykes had signed and certified the certificates for the annual renewal of Schardt's bond as teller. At the time this witness was called as such by the defendant in error, there was pending a litigation on behalf of the bank, by the assignee, against him. He was asked if, during the year 1892, he received any information that John Schardt was speculating. His answer was: "Some time in the summer or fall of 1892, a gentleman by the name of Kyle came here (Nashville) from New York, representing Myers & Co. Kyle wanted me to become interested in the brokerage business, and represent Myers & Co. at this point. I told him I did not like the idea, because it would be purely a speculative business,

and he then said that that made no difference; that John Schardt, *our* teller, was a part owner in a similar concern." He was then asked if he "had imparted this information to any one." His answer was: "Yes, sir; I *once* told Mr. Baxter, the president of the bank, of this conversation." He was then asked if he told Schardt what Kyle had said. His answer was: "Yes, sir; on the *next day*. I think I told Schardt what Kyle had said," and that Schardt "admitted that he had at *one time* been interested in such a concern, but had sold his interest, and that he had speculated to some extent, but had made money on every transaction, and had seen the error of his way, and had ceased to do so any more." He says that he "*immediately* told Mr. Baxter, the President of the bank, *what Schardt had said.*" Sykes further testified that "some time thereafter I received an anonymous letter telling me that Schardt had been speculating," which letter he says he showed to Baxter, who told him "not to pay any attention to an anonymous letter."

Record, 77–79.

This witness' deposition was taken about May 15, 1895. The matters about which he gave his testimony had occurred in the "summer or fall of 1892." His deposition was taken to fasten notice on the president, Baxter, and thereby on the bank, of the fact that Schardt had been a part owner in the "brokerage business." He said: "I once *told* Mr. Baxter, the president of the bank, of this conversation." When did he tell Baxter? Before or after the bank assigned? Before or after the expiration of the bond? Why does he not say when it was? Why was he not asked *when* it was? He remembers, he "thinks," that he talked to *Schardt* about the Kyle conversation "the next day" after it occurred. He remembers that he "immediately" told Baxter that Schardt admitted that he had *at one time* been interested in such a concern—i. e., brokerage business

—and that he *had speculated* to some extent, but had made money in every transaction.

10. Do the foregoing constitute "becoming aware?" The word "aware" is not used in this policy, as the word "heard" is used in the cashier's policy. Nor is the word "aware" the synonym of *heard*. Aware is universally defined as "possessing knowledge," "conscious," "cognizant," "informed through the senses," but is a synonym of "certain," "certified," "sure."

Employers are not required to make charges against their employes by giving notice to the sureties of the latter upon *suspicion*, "but only after the bank had knowledge of such facts as would justify the charge."

American Surety Co. v. Pauly, 170 U. S., 131.

11. It is said that the bank did not pursue or investigate these vague and anonymous charges. The bank had not agreed to do so. It had not so covenanted in its bond. It is quite clear that the bank was not obligated under this contract, or independently of it, to ransack Schardt's past life, or to run down rumors and suspicions, and make written reports of them to the company. The insurance company had its agent—Cooley —at Nashville to do this character of work.

State v. Atherton, 40 Mo., 207.

12. There can be no doubt that Schardt abstracted a very large sum of money from this bank, but that he ever lost one cent in gambling or speculations has not been specifically proven in this record. Not a single instance of either has, as a fact, been proven, and had he not told Eatherly on his death-bed that he lost the money "speculating in New York," we would be left to surmise as to how it went. This confession was made after the bank had closed its doors and had ceased to do business.

II.

SECOND ASSIGNMENT OF ERROR UPON THE TELLER'S BOND IS:

"*The bank procured the teller's bond to be renewed in January,* 1892, *by representing that the employe's books and accounts had been examined and verified, when the books showed a default of* $23,364.44 *in a bank with a capital of only* $50,000.

1. Our opponents insist that upon each annual renewal of the teller's bond, the company sent out from Montreal a circular to the bank, which it was necessary for some officer of the bank to sign and return, and that among many other things contained in said circular, were the following: "The accounts of said teller (Schardt) had been examined and *verified* by the finance committee," and that this was a condition precedent to the renewal. That, in fact, the account had not been examined and verified; and, therefore, it was a falsehood, and deceived the company in the issuance of the bond, being a material and important fact.

We say that the original contract made all arrangements for these renewals, and fixed in advance the terms and conditions thereof.

Its language is:

"Now, therefore, in consideration of the sum of one hundred dollars, lawful money of the United States of America, to the said company (paid), as a premium for the term of twelve months, ending on the sixteenth day of January, 1889, at twelve o'clock noon, *and in order to effect a continuance of the currency of this bond,* a like premium hereafter to be paid to the said company on or before the sixteenth of January in each year, as a premium for the ensuing year, so long as said employer may wish to continue this bond, and the said company shall consent to receive said premiums," etc.

Here is no reservation for either party to alter the contract, and no notice that there would be any effort to change it. On the contrary, the parties agree to annual renewals upon "the payment of a like premium *hereafter* to be paid to the said company so long as the said employer may wish to continue this bond, and the said company shall consent to receive said premiums."

Cumulative to the above, the bond recites:

"The following provisions are also to be observed, and binding, as a part of this bond. The actual payment of the premium, and its acceptance by the company, either for the issue or renewal of this bond, is essential to its currency, and a condition precedent to the right or claim hereunder."

Again, we have: "That this bond is issued and *renewed* on the express understanding that the employe has not, *within the knowledge of the employer*, at any former period, either in this or any other employment, been guilty of any default or serious dereliction of duty."

The foregoing constitute all the conditions for the annual renewal of the bond. After the expiration of a twelve month, the contract is to be renewed. As respects *time*, a *new* contract is made, but it contains only the terms of the old contract. May says it is generally held to be a new contract upon the terms and conditions stated in the policy expired, the old application, in the absence of evidence to the contrary, serving as a basis of the new contract, and as if made at the date of renewal.

May on Ins., sec. 70 a.

As respects the "examination and verification" of the books or accounts of this office, not one word is said in the original bond. I now quote what it does say:

"That there shall be an inspection or audit of the accounts or books of the employe on behalf of the employer at least once in every twelve months from the date of this bond."

2. The company had put a number of questions to the officers of the bank, which were to be, and were, answered, to ascertain, before taking the risk, the habits of the bank in respect to these very matters, such as "when was the last *inspection* of the office?" "What is your custom in regard to the frequency of *inspection?*" "Are they at stated periods or irregular?" and "What is the longest time allowed to elapse between inspections?" "Has the bank a duly and authorized inspector? If not, by whom are the inspections made?" "In the event of the employe filling the post of teller, how often, and by what officer will the teller's cash be checked and counted?" And to conclude it all, the contract declared in express words: "That there shall be an inspection or audit of the accounts or books of the employe, on behalf of the employer, at least once in every twelve months from the date of this bond."

This circular, which contains the words, "examination and verification," it is now claimed requires more of the bank than was required by the original contract, or than is expressed by the words, "inspection or audit," and an effort is thus made to alter the contract in a sidewise, unadvised, and unconscionable manner.

Our contention is, that under this contract the bank was required to do certain things in respect to the books and accounts of its teller, and these things, we claim, it did, and this contract was to continue from year to year, upon the payment of the premiums, so long as the one paid and the other accepted it. At the end of the year, and when the bank had determined to continue the contract for another year, and to pay the premium, this paper, not purporting to change the contract or the duties of the bank, then past and ended, came to the bank, and hidden in it are the words, that the teller's accounts had been "examined and verified" by the finance committee, whatever these words mean. We insist that said statement in respect to "verification,"

was not a condition of the original contract, as set out in the bond or guaranty; was not called for therein as a condition precedent to renewal, but was intended as a catch, slyly and cunningly devised to defeat ultimate liability, and to entrap the unwary. Judge Wallace aptly illustrated this practice of some insurance companies inserting fatal conditions in unsuspected places. He said: "It was probably inserted where it is found with the purpose, on the part of the insurance company, of escaping any liability in the event of a loss, if it should see fit to do so. But it is inserted in a part of the policy where it would not naturally convey that meaning to the insured." Hogan v. Aetna Ins. Co., 95 Fed. Rep., 106.

3. We further contend that the words of the original contract are the contracting and controlling words of the parties, measured by each before executing the contract, and fixed forever their rights and duties under *that* contract so long as it existed, as between themselves, and that its legal effect was not to add anything to the contract as a condition or provision, but should be construed in connection with and to have reference to the words, "inspection or audit," as set out in the original contract. That having required the bank to perform specific duties in the original contract, it cannot subsequently limit its liability and defeat the entire contract by requiring the bank to do those same things by using stronger words, or increasing the bank's duties beyond its original contract. Nowhere in the original contract had it exacted of the bank a "*verification*" of the accounts of the teller. "Verification," as now contended for, means such an examination and comparison, inspection and scrutiny of the books and accounts of the teller as would detect any embezzlements, however cunningly contrived or hidden upon the face of the books. If these companies will make it apparent or visible upon the face of the contract what is now

and here contended for, they will quit the field of competition for business and patronage quite soon.

The condition of the original contract, and of each renewal was: "That there shall be an *inspection* or *audit* of the accounts or books of the employe, on behalf of the employer, at least once in every twelve months from the date of this bond." This is what the bank agreed to do, and this is what it understood it was certifying it had done. It is argued here as if the bank had made a contract for such effective and absolute supervision as would detect and prevent abstractions of its funds, and in this circular solemnly certified that it had done so, and the bond was renewed on the faith of this statement, as if it was a guaranty on the part of the bank that the past was forever closed, and that the bank had somehow estopped itself from looking into past embezzlements, and that it would be a fraud on its part to insist thereafter that there were or had been embezzlements.

The court will observe that the very words of the contract put the only limitation upon retro-examination and discoveries in this language: "Committed by him and discovered during the continuance of this bond, and within six months from the employe ceasing to be in said service" (Rec. 12), showing thereby that back inspection of the books of the employe were intended, notwithstanding a renewal in the meantime. The effect of the contention of our opponents, in view of all the facts, is this: The bank agreed to make an "inspection or audit" once in every twelve months, and then at the end of the twelve months, to make the bank say that it had "examined and verified."

5. The attention of the court is called to the fact that the cashier, Peden, during his term of that office, and Durr as his successor, and Sykes as his successor in the same office—the several cashiers—are the persons who signed and returned to the

company the circulars sent out annually, stating that the accounts of said Schardt, as teller, had been examined and verified by the finance committee.

(See Stipulation, p. 106, of Record.)

As it is insisted that the circular made a change in the original contract, which we deny, but if it does, then we insist that a cashier had no power to make such a change, and for this insistance, we rely upon the following:

American Surety Co. v. Pauly, 170 U. S., 133.
Fidelity, etc., Co. v. Gate City, etc., 33 L. R. A., 821.

The original contract did not anticipate that it was to be changed by any one, much less by a cashier unwittingly.

III.

The third assignment on teller's bond is:

"The bank agreed to observe, or cause to be observed, all due and customary supervision over the said employe for the prevention of default," and during the currency of the bond ceased to compare ledger balances, or correctly count the notes held by the bank, which was not only customary with other banks, but was customary in this bank up to the time the shortage commenced."

This assignment is based upon the following provision of the policy:

"That the employer shall observe, or cause to be observed, all due and customary supervision over the said employe for the prevention of default, and if the employer shall, at any time during the currency of this bond, condone any act or default on the part of the employe which would give the employer the right to claim hereunder, and shall continue the employe in his service, without notification to the company, the said company will not be responsible hereunto for any default which may occur subsequent to said act or default of said employe so condoned."

1. Our reply is: This is a very broad and indefinite expression, and is easily susceptible of several interpretations.

"*All due and customary supervision over the said employe for the prevention of defaults,*" it is now contended by the company, that it is susceptible of but one meaning or interpretation, and that it relates alone to "*a comparison of ledger balances, or to correctly count the notes,*" and that herein the bank covenanted that it "would compare ledger balances," and that it would "correctly count the notes." If that be its meaning, it is the poorest and most meager expression of that thought ever recorded. It is an intellectual alibi to the original.

It says nothing in respect to the books, comparing the same, or counting notes. "Supervision *over the employe*" for, etc. Literally, it has no reference to books or notes, but does refer personally to the employe as respects his daily habits, associations, morals, his prompt and daily presence at the bank at the usual and customary hours. When construed in connection with its context, it is clear that it refers to the *person*, and condonation of his acts and defaults. The balance of the sentence is consistent with this view and inconsistent with the contention of the company.

2. It is now a universal principle of law in the construction of papers written by insurers or guarantors intended for the public to accept as written, that all ambiguities, obscurities, and uncertainties are to be construed against them and in favor of the public or insured, and if the paper is open to two constructions, the courts will give it that construction most favorable to the insured.

American Surety Co. v. Pauly, 170 U. S., 132.
Imperial Fire Ins. Co. v. County of Coss., 151 U. S., 452.

3. Again, the company had made inquiry and been told all it desired to know in respect to the books of the bank—i. e., when they were inspected, by whom they were inspected—and had put its ultimatum to the effect that they should be *inspected* at least once in twelve months. The bank had made full disclosures of its modes in this respect, and told every fact it was asked in regard to its books, inspections, etc. The insurance company, after hearing thus from the bank, prescribed nothing additional, nor did it prescribe either the extent, vigilance, or scrutiny of the inspection, or how it should be done, and what it would expect the bank to do additionally.

4. Beside, the insurance company had been told in the application for the policy, which application and all the questions therein it had prepared and submitted, that there would be an "inspection or audit of accounts or books of *the employe*, on behalf of the employer, once in every three months," and was content to issue the policy on this; at the same time it was told that this would be done by the finance committee.

5. There was no agreement that the books of other officers or clerks would be compared with his.

33 L. R. A., 821; 30 Id., 581.

6. The only limit upon the extent of the liability of an insurance company must be found in the clear and unambiguous language of the contract. *Indemnity* is the purpose of the contract. This is what the premium is paid for, and there can be no inference against full indemnity. Every condition or proviso intended to defeat all indemnity, or to forfeit the policy, will be strictly construed.

7. It is said by our opponents "that if an employer *knows* that an employe has been guilty of dishonest conduct, and conceals the information from the contemplated surety, the bond is void, whether the intended surety made inquiry in respect to the same or not."

I do not concede such to be the law, but if it were such, it would not militate against the bank, for the reason it will not and cannot, from the record, be stated that the bank, or its president or directors, *had knowledge* of Schardt's dishonesty and previous defalcation.

Other adjudications hold differently from the above annunciation.

6 Peters, 217; 11 Wheat., 59; 22 U. S., 93; 9 R. I., 168; 52 Pa. St., 343.
Frelinghuysen v. Baldwin, 1 Pet., 452.
Magee v. Manhattan Co., 92 U. S., 95.

8. **The real question in this case is not that stated above, but is this:** The books of the bank would reveal to expert accountants, upon a vigilant examination, that Schardt was a defaulter, but this fact had never been suspected by the president or directors of the bank, or any one else. It is generally held by the courts "that negligence of the bank, or its officers, in failing to examine the books, and to discover the defalcations of its officer or clerk, does not release the sureties on his bond given for the faithful performance of his duties."

Lieberman v. First National Bank, 40 Atl., 382.
Bank v. Root, 2 Mete. (Mass.), 540, by Shaw, C. J.
Taply v. Martin, 116 Mass., 275.
Bank v. Stephens, 39 Me., 532.
Farmington v. Stanley, 60 Me., 472.
United States v. Kirkpatrick, 9 Wheaton, 72.
Wayne v. Bank, 52 Pa. St., 343.
Phillips v. Bossard, 35 Fed. Rep., 100.
Sparks v. Bank, 3 Del. Ch., 302.

Graves v. Bank, 10 Bush (Ky.), 23, has been overruled in every case in which it has been discussed, and stands alone and unsupported.

Lieberman v. First National Bank, 40 Atl., 386.
Bank v. Albee, 63 N. H., 161.

IV.

ASSIGNMENT ON TELLER'S BOND.

This assignment is in this language:

"The bond provided that there should be 'an inspection or audit of the accounts or books of the employe on behalf of the employer at least once in twelve months,' yet the ledger balances were not compared, and the notes in the bank were not counted or compared with the amount called for by the books. Every page in the books kept by him was incorrect, and no inspection or audit of his books or accounts was made."

This assignment is based upon the following condition of the teller's bond:

"*That there shall be an inspection or audit* of the accounts or books of the employe on behalf of the employer at least once in every twelve months from the date of this bond."

We reply:

1. This assignment is not well taken in fact. That there was an inspection or audit, as the bank understood these words, every three months, and also every six months, additionally, there can be no doubt, and surely either of these would be a compliance with the agreement, "at least once in every twelve months."

2. The real point of this complaint is not that the bank did not continue the inspections or examinations as it did at the time the first policy was issued, and as it had done before that time, and continued to do afterwards, but that all these inspections, or audits, were too superficial to meet the requirements of the contract.

I have great confidence that any examination of the books of the employe which fell short of detecting and exposing his defalcations, would, in the estimation of the company, have been

too superficial, and not a compliance with its idea of what was required.

It is claimed that what examination the bank made did not amount to either an "inspection or audit," as these words are now understood by the company.

In proof of this we are referred to the fact that original entries on the books were fraudulent; that the books were full of false additions, and other frauds, which a more expert and scrutinizing inspection ought to have discovered.

Since the experts, McEwen and Jennings, assisted occasionally by another, have labored on these books for several months, called in all the pass books of depositors, explored original entries, uncovered those which were false, pointed out every false addition made of long columns of figures, and exhibited failures on the part of this employe to enter upon the books moneys paid to the bank, and how, after having made false entries in one book, he would falsify entries in other books in order to prevent detection, and make them correspond as a whole, it is quite easy now to see how these might have been detected by the finance committee, and how apparently negligent this committee was in not discovering them before. Our *ex post facto* information reflects back and sheds light upon things not seen before, and enables us to see things lying now upon the surface the very existence of which we never suspected before.

These expert bookkeepers having dragged from their hiding places fraudulent entries, and pointed out their relations to other entries, and shown the false additions, our adversaries say joyfully: "See, how easy it would have been to have detected them!" And the finance committee is made to rest under the aspersions of stupidity, dullards, and negligent officers, though it was their money which was being abstracted.

3. The argument of our opponents is, that the books kept by Schardt had hidden, under their surface, every false entry now brought to light, and that these entries were as open to the discovery of the finance committee as they were to the experts, and but for the *negligence* of the finance committee in failing to make an expert examination would have been discovered at an earlier period, and before the losses became so large, *ergo*, the finance committee did not make the contemplated inspection or audit. This court replied to that argument in this language: "This is substantially construing the contract as a guaranty to the defendant company against the bank's carelessness in making the examination," and I might add as guaranteeing to the company that each quarterly inspection closed all matters to that date.

4. Insurance is taken to secure the insured against his own negligence or inexpertness, as well as that of his agents, servants, or committees. The contract nowhere calls for infallible inspection. If such they had to be, there would be no necessity for insurance.

5. It is said that it contributed to the teller's opportunities to embezzle, successfully, the moneys of the bank, and avoid detection by allowing him to discontinue the trial balance book in 1890. So, it contributed to his opportunities to embezzle by employing him at all, or in allowing him access to the money of the bank. It was never contracted that the bank would have a trial balance book, or any other particular book. No inquiry was made as respects the number, character, or office of any book, but only that such books as were kept should be "inspected or audited at least once in twelve months."

6. I do not understand how, if original entries were false in one book, and all the other books were made to conform to this fraud, how a trial balance book taken from these false entries, or *vie versa*, would have prevented the fraud or detected it. The

company did not guarantee his honesty on condition a trial balance book was kept, or that the bank would so order and arrange books and compare them that he could not embezzle without detection, but did guarantee that he would not be guilty of embezzlement.

It seems now probable that Schardt dropped the use of this detective trial balance book as a part of his scheme to embezzle the money of the bank, or because of the additional labor it would require to make it conform to false condition of the other books. If he would falsify one book, he would another.

7. Certain it is the honesty and fidelity of Schardt was the fact insured, not honesty so hedged about that he could not be dishonest: not honesty *compelled* and *enforced* by active and sleepless vigilance; not fidelity extorted by an impending threat that an expert accountant would be put and kept upon his tracks, at a greater expense to the bank than the premium paid annually for this insurance.

8. It is generally known that there are two modes of inspecting the books of a bank officer or clerk. One is that made by the finance committee of the bank, which never goes to original entries, never adds up columns, or calls in pass books, but accepts as correct statements furnished by the cashier purporting to be taken from original entries. The other is that made by expert bookkeepers, who do go into original entries and make comparisons of the entries made in various books and which bear upon each other, and adds up long columns of figures, calls in all pass books of depositors, and compares entries made in them with entries in the individual ledgers.

9. It was clearly understood by the company, from the questions and answers disclosed in the application, that inspections had been made by the finance committee, and that this would continue in the future, and no objection was made. It is fair

to infer that the company knew that the finance committee of banks was made up from the body of the shareholders, and was composed of those largely interested, pecuniarily, in the success of the bank, and the company was willing to leave it to such a committee to make inspections. Judge Clark held on this point: "So long as the bank officers and committee acted in good faith, such examinations as the finance committee thought sufficient for the protection of the bank and its stockholders would satisfy the requirements of this contract. If anything more was wanted, it was a matter for specific agreement."

10. It is pressed with zeal and repetition upon the court that "ledger balances were not compared," "or the notes of the bank counted or compared with the number or amount called for in the books." Here is the evidence on these points:

John A. McEwen, a member of the finance committee, testified:

"A. We counted all the money, or things that represented money, such as cash tickets, checks on other banks, deposits in other banks, and compared this with the statement furnished us by the cashier or teller. Then we took possession of all notes, bills, time or demand loans, or other papers showing an indebtedness to the bank, as well as collaterals attached, and did our best to ascertain the condition of the paper and the value of the collaterals. We compared this with a statement furnished by the cashier or teller of what should be in the bank of these kinds of papers, and also compared it with the daily balance book. As we had seen all notes or bills which had been discounted by the bank, and these had been entered on the daily balance book, we would sometimes go back to it. We always took the cashier's or teller's written statement of the deposit account; we hardly ever examined original entries of deposits, but accepted this statement as making a full and fair exhibit of these. We could not have examined original entries. There were several hundred depositors, and a great may small accounts with individuals; it would have taken all our time to have done this, and but few, if any of us, were bookkeepers or accountants; we had to rely upon the honesty of the cashier for this. We did our best to ascertain the exact condition of the bank at the end of each quar-

ter. The finance committee was the discount committee, and all paper approved by the committee was recognized by the committee at the quarterly examination. If we did not remember it, we appealed to this book of original entries on the ticket. These quarterly examinations were of the same kind and character which all the banks of Nashville made, as we understood."

James B. Richardson, another member of the committee testified:

"A. At these meetings there was always present either all of the committee, or if not all, certainly three of us were present before we commenced the examination. We always counted the cash, and cash items, all notes, time or demand loans, bills, and every paper due the bank was produced and examined, credits on the back of each taken off—all collaterals examined, and estimated values put upon the collaterals, all aggregated and compared with the daily trial balance book. The daily balance of individual deposits and certified checks and bills payable as shown on the daily balance sheet, as exhibited by the cashier, were examined. We did not go to original entries in the individual ledger, but accepted the statement, in writing, of the cashier for this. To have gone to original items and added up columns would have required an enormous expense, and much more time than could have been given it by directors, or its committees, and it is not the custom or habit of committees to examine original items and entries, I understand, in this respect, but to accept the written statements of the cashier as correct. In addition to this, we, individually, would, at times, go into the bank and look over the individual ledger in a general way, as well as the general ledger. I did this and have seen others do it. In addition to this, the cashier would make semiannual reports to the directors, which were examined. These reports accorded with the results of the quarterly reports, and were passed on by the board of directors. These reports related to the general condition of the bank, showing its financial status, and what had been made, and what had been lost during the preceding six months, and showed in general detail the facts upon which such a result was obtained. It purported to be a complete report in every respect, and upon this depended the ability of the bank to declare and pay a dividend or not."

This finance committe was the discount committee, and had seen all the notes or bills which had been discounted, and these had been entered on the daily balance book.

11. Exhibit X. (pages 15-24 of Record) shows every item of the default which the experts charged to Schardt, what book the same can be found in, and the page, and by what manner it was accomplished. The court will see from the said exhibit that "an overwhelming part of the defalcation of Schardt was caused by misstatements on the books kept by him as to amounts due individual depositors." Rec. 39, ques. 23, ques. 24, 34, ques. 4, page 38, ques. 14, says nearly all of the shortage was covered by misstating the amount due depositors. The *notes* which he manipulated in his own interest amount to $, and are set out as follows: Collected on demand loan John Thompson, $590, credited it on the demand loan, but not on cash book. A. W. McClure, $25, collected on note, credited the note, but failed to enter it on cash book. The two above were made in 1893. (See Rec. p. 19.) The next six items are small notes. He collected these and gave up the notes, but failed to enter the collections on cash book. The next eleven items were like the last. In 1892, he collected on a note of C. H. Brandon, $250, credited the note but failed to enter credit on cash book. The court thus sees that of the several hundred of items composing the abstraction only about seventeen items are connected with notes, and these are scattered over three years' of time, and comparatively amount to but little. John A. McEwen tells how this might have occurred. (Rec., 92.) The committee would call for all notes, etc., and the cashier would hand them the entire package. The cashier at the same time would hand them a list of all the notes that should be in the bank. The notes were compared with the list. If the cashier had put down more or fewer notes than there were the committee would discover it, but, if both were identical in number, it would create no suspicion. Every one of this character of embezzlement occurred—i. e., in which the notes were taken—occurred in 1890, while Sykes was cashier, and may have, or not, furnished the list. If a payment

had been made on a note, in all cases the note was credited, but no entry was made on the cash book (C. B.) by Schardt, and he put the money in his pocket.

The evidence is overwhelming that in no bank do the finance committee explore the books for original entries, but universally accept the written statements and reports of the cashier or other executive officer who acts for him when he is sick or absent.

A. W. Harris, p. 73, q. 3, 4.
McLaughlin, p. 82, cross-ques. 2.
Duncan, p. 85, q. 31 and 37.

"It is not the business or duty of directors to go back to original entries."

Briggs v. Spaulding, 141 U. S., 132.

The argument is made that while the bank had only $50,000 *of capital, it lost by Schardt's defalcations more than twice its capital stock—more than* $100,000—*in the years* 1890-91-92, *and to April,* 1893, a little over three years, and this is presented to the court as proof of great negligence on the part of the finance committee.

Baldly stated, it would seem so.

This, however, is readily accounted for when the facts are considered:

1. Nine-tenths or more of the embezzlements were taken from depositors and from payments made on notes and bills while the money was passing from the hands of the depositor, or the payor, to the bank, and properly entered upon the pass books, or credited upon the notes, but not entered at all on cash book, or if entered on cash book, was entered for a false amount. So it was impossible to ascertain the amount of embezzlements until the pass books were called in, and the notes traced to original entries. In some cases no deposit ticket could be found. To these were added false additions of long columns, and corre-

sponding alterations of the books to make them apparently harmonize with each other. It is hard to imagine greater confusion or more ingenious methods.

In this view, the question put to Mr. Harris, on cross-examination, was hardly a fair one. It was: "Do you think that any scoundrel could steal the full amount of your capital stock and surplus without detection?" (Rec. 73.)

I can easily imagine that a bank with a small capital stock and a large daily deposit, with several hundred depositors, made up of laboring people, whose daily deposits were small, by the dishonesty of its teller in appropriating each deposit in whole or part, and making no entry, or a false one, on the books—to say nothing of other manipulations, could appropriate an amount equal to the capital stock and the bank know nothing of it for months or years, and until a final wind-up and general account was had.

3. The record discloses that the capital stock of this bank was $50,000, its undivided profits $23,116.63, its individual deposits $140,291.57, its certificates of deposits $14,682.75, making in deposits alone more than three times its capital stock.

Record, 44, 45.

Its discounts and demand loans averaged nearly $100,000 each.

Rec., 44, 45.

These presented ample opportunity and margin for an ingenious bookkeeper and embezzler to exercise his skill.

IN THE MATTER OF THE CASHIER'S BOND.

This bond is dated January 1, 1893, and is in the penal sum of $20,000.

Rec., 6–9.

This bond was only in existence from January, 1893, to April 17, 1893, when Schardt died. The amount claimed on this bond is $22,964.17 of principal. This sum was abstracted by Schardt, as cashier, between January and April.

The bond recites:

"Whereas, the said employe has been appointed cashier at Nashville, Tennessee, in the service of said employer, and has been required to furnish security that he shall not be guilty of any FRAUDULENT act in the performance of his duties in said capacity by which the said employer shall suffer any pecuniary loss."

Later, by recitation, the bond undertakes to limit the liability of the guarantee company (1) to any act of fraud committed by the said employe in connection with the duties of said appointment, and constituting EMBEZZLEMENT OR LARCENY.

This bond contains also the following:

"Now, therefore, this bond witnesseth, that the said employe for and on his own behalf, and the said company fully relying on the truth of his statement and declaration contained in a certain document distinguished as employer's guarantee proposal No. 154,806, dated the 10th day of January, 1893, and signed Lewis T. Baxter, president, on behalf of the said employer, and lodged with the said company at its office in Montreal, and on the strict performance and observance hereafter, *by the said employer* of the contract thereby created, do hereby, respectively, severally, and jointly covenant with the said employer to reimburse unto the said employer, or his or their representatives or assigns, the amount of any loss not exceeding in the whole the sum of twenty thousand dollars, which, during the currency of this bond, shall be sustained by the said employer by reason of any act of fraud committed by the said employe in connection with the duties of said appointment, and constituting embezzlement or larceny—such reimbursement to be made within three calendar months next after proof shall have been given to the satisfaction of the directors of the said company, of the occurrence of such loss, and the proof thereof to include, if the company shall so require, an affidavit to be made or taken by the person for the time being entitled to the benefit of this guarantee, to the effect that he hath been actually

defrauded by the said employe, and that he suffers absolute and ultimate loss thereby to the full amount claimed hereunder, and that the contract created as aforesaid, hath been fully performed and observed on the part of the said employer."

Said bond also contains the following:

"Provided always that this bond and guarantee hereby granted or undertaken shall be subject and liable to the terms and conditions hereupon indorsed."

I shall notice only such of these conditions as are supposed to be material to this litigation, as follows:

"2. That said employer shall use all due and customary diligence in the supervision of said employe for the prevention of a default, and to that end shall cause an inspection or audit of his accounts to be made at least once in twelve months, and if the said employer shall, at any time during the currency of this bond, become aware of any act or default on the part of such employe, which would constitute a claim hereunder, and shall continue said employe in his service, without notification to the said company, the said company will not be responsible hereunder for any loss or default which may occur subsequent to said act or default of said employe.

"3. That any written answers or statements made by, or on behalf of said employer in regard to, or in connection with the conduct, duties, accounts, or methods of supervision of the said employe, delivered to the company either prior to the issue of this bond, or any renewal thereof, or at any time during its currency, shall be held to be a warranty thereof, and form a basis of this guarantee, or of its continuance.

"4. That the said employe has not, to the *knowledge* of said employer, been guilty of any serious dereliction of duty or default in this or any other service, or that his habits have been such as to incur said employer's censure previous to the issue of this bond.

"6. This bond shall extend to cover only such losses as may have been incurred by reason of the *fraud* of the said employe during the currency of this bond, and within twelve months previous to the notification to said company of any default hereunder."

This cashier's bond was issued upon what is called employer's guarantee proposal No. 154,806, and which is signed by Lewis

T. Baxter. I now quote from this all the questions and answers supposed to be material to this suit, omitting all immaterial.

Rec. 107.

"Ques. 3. Has he ever been in arrears or default in the bank's service, or, as far as you have heard inay previous employment?

"Ans. No.

"Ques. 4. Have you known or heard of anything unfavorable as to his habits or associations, past or present, or of any matters concerning him about which you deem it advisable for the company to make inquiry?

"Ans. No.

"Ques. 13. When were applicant's books and accounts, including cash, securities, and vouchers (if any) last examined, and by whom?

"Ans. December 31, 1892, by finance committee (where they found correct), of bank, and found correct.

"Ques. 14. In case of applicant's handling cash or securities, how often will the same be examined and compared with the books, accounts, and vouchers, and by whom?

"Ans. Not less than quarterly, and often monthly, by finance committee.

"Ques. 16. Will applicant handle funds or securities not subject to routine check or periodical examinations? If so, please describe their nature.

"Ans. No."

All the above and many other questions and answers are concluded by this general printed language:

"The above answers and representations are true to the best of my knowledge and belief." Dated January 10th, 1893. Signed. "Lewis T. Baxter. Official title, President."

The first assignment of error is:

"1. *The bank represented that it did not know of, and had not heard of anything unfavorable as to the habits or associations, past or present, of the employe upon whom it was seeking the issuance of the bond, yet at the same time the bank, and the particular officer making the statement for the bank, knew that the employe had been engaged in speculation, and had been a partner in a gambling concern while occupying a position*

of trust in the bank, and no effort was made to verify his statement that he had sold out his interest in the bucket shop, and had ceased speculating."

The court perceives that this bond makes an effort to create a *warranty* "in respects to all written statements or answers made by or on behalf of said employer in regard to or in connection with the conduct, duties, accounts, or method of supervision of the said employe, delivered to the company either prior to the issue of this bond, or any renewal thereof, or at any time during its currency, shall be held to be a *warranty* thereof, and form a basis of this guarantee, or of its continuance."

Baxter, the president, had said, in writing, that *he* had not known or heard of anything unfavorable as to Schardt's *habits or associations,* past or present, or of any matters concerning him about which *he* deemed it advisable for the company to make inquiry.

1. The court will observe that the declaration of Baxter concludes with this sentence:

"The above answers and representations are true to the best of my knowledge and belief." Signed. "Lewis T. Baxter. Official title, President."

The *bank* made no representation of any character unless this statement of Baxter be held to be [illegible] statement.

Let us inquire what is the legal effect of Baxter's qualification, by the use of the words, "true to the best of my knowledge and belief."

The authorities are generally, if not entirely agreed, that where such words occur, in order to avoid the policy, it must be proven that the declarant has been guilty of a *"willful untruth."*

1 Biddle on Ins., sec. 562, citing
Clapp v. Mass. Benef. Asso'n, 146 Mass., 519.
United Breth., etc., v. Kinter, citing France v. Aetna

Ins. Co., 94 U. S., 561; Ins Co. v. Gridly, 100 U. S., 614, and other cases.
National Bank v. Ins. Co., 95 U. S., 673.

Every reply made by Baxter to the questions submitted has this qualification, and in order that such answer shall be available and effective, defendant in error should show that in these answers he uttered a willful falsehood.

2. *"Unfavorable as to his habits or associations, past or present."* January 1, 1893, no man had better "habits or associations" than Schardt, so far as Baxter knew, or so far as the public knew. As respects his "past," Baxter had not seen the anonymous letter to Woodward, for, according to the most reliable testimony, it had not been written. Woodward did not resign until February, 1893. Its reception is fixed by the witness with reference to the time of that resignation.

This sends us back to Sykes' testimony, substantially. He says that in the summer or fall of 1892, he told Baxter what Schardt had said. Well, what had he said? "That at one time he had been interested in a brokerage association, but sold his interest, and that he had speculated to some extent, but had made money, but he had ceased to do so any more." It is nowhere shown that Baxter knew of the Kyle conversation at this time. Let us suppose that Baxter had heard by means of an anonymous letter that Schardt had, at one time, owned stock in a brokerage association, or that he had one or more transactions in speculating, these cannot be said to constitute "habits or associations," and it was *"habits and associations"* which this question asks about.

These cannot be said to constitute habits or create associations.

Aetna Ins. Co. v. Davis, 123 U. S., 739.
3 Joyce on Ins., sec. 2070.

There is a clause in the bond which must be read in this

connection, as it pertains to the same matter. It is: "That the employe has not, to the *knowledge* or *belief* of said employer, been guilty of any serious dereliction of duty or default in this or any other service, or that his habits have been such as to incur employer's censure previous to the issue of this bond." The question calls for Baxter's personal knowledge or belief. He had no *knowledge* is certain, and he said he had no belief which he deemed it advisable for the company to make inquiry about. The argument is that he should have had a belief, and that the court should so hold.

"When a statement is made in good faith and from the best information the declarant has, it should not defeat a recovery, though it was untrue."

Supreme Lodge v. Dickson, 52 S. W. Rep., 862.
(Tennessee case.)

Falsehood cannot be predicated of an opinion, as to whether Baxter had heard anything concerning Schardt which *he* deemed it advisable for the company to make inquiry about.

52 S. W. Rep., 862.

I deny that insurance or guarantee companies can select any person connected with a corporation or partnership, either its president, clerk, or porter, and put a lot of questions to him in respect to his beliefs about other employes, and whether the party questioned has a belief which *he deems* it advisable to publish, and thereby affect, in any way, especially forfeit, an indemnity bond given for the fidelity of the person inquired about.

This goes upon the theory that insurance or guarantee companies, by reason of this confidence game, can make some one its detective to run down every loose rumor in respect to some employe, no matter how ignoble the source or vehicle of the information.

Representations, expectations, belief or opinion, without fraud do not avoid a policy.

2 Joyce on Ins., secs. 1903–4, and cases cited.
Beham v. United States Guarantee Co., 7 Exch., 744; 21 L. J. Ex., 317.

II.

The second assignment on the cashier's bond is:

"The bank procured the issuance of the cashier's bond by representing that the books and accounts of the employe, who had been teller for five years, had been examined and found correct to the end of his term of office; yet, at that time, the books of the bank showed a default of $73,992.35, *in a bank with a capital of* $50,000."

This assignment is based upon question 13, put to Baxter, and his answer thereto. The question is: "When was applicant's books and accounts, including cash, securities, and vouchers (if any) last examined, and by whom?"

"Ans. December 31, 1892, by finance committee of the bank (were they correct), and found correct."

1. This answer was given under the qualification, "to the best of my knowledge and belief."

The evidence abundantly shows that the books and accounts had been examined December 31, 1892, by the finance committee, and found and reported by that committee to be correct.

2. If this assignment has any merit, it arises, not out of the fact, but the mode, extent, and thoroughness of that examination, which I have discussed hereinbefore.

3. The *examination* of December 31, 1892, was the one made under the teller's bond, where it is called "*inspected* or *audit*," and Baxter evidently believed that the question had reference to this, and answered accordingly. Personally, I do not believe

that it had that reference. That matter had been settled by questions 3 and 5, as follows:

"Ques. 3. Has he ever been in arrears or default in the bank's service, or as far as you have heard in any previous employment.

"Ques. 5. Is he, to your knowledge, pecuniarily embarrassed or insolvent, or is he in any way indebted to the bank."

I believe that the answers to the two questions above exhausted the inquiry, and that the question, 13, had reference to future renewals of this bond.

If I am wrong in this, then we have the company's own construction of the words, *"audit and inspected,"* in the teller's bond, and here the company defined them, or it, to mean *"examined,"* and under this light "examined and verified" as contained in the circular sent out annually, is much modified.

III.

The third assignment on the cashier's bond is:

"The court allowed $5,992.35 of overdrafts, 'allowed but not authorized,' as a part of the default, for which the company was liable, although the bond only protected the bank against a default 'constituting embezzlement or larceny.'"

We have several replies to this:

First. Every item of embezzlement and larceny making up the large sum reported by the experts, was set out in what is known in the record as Exhibit X to the bill, and was a part thereof. Said Exhibit X only purports to show the *embezzlements and larcenies* of the cashier and teller. It makes no effort to exhibit any item that had been honestly dealt with, as shown by the books. Said exhibit occupies about six pages of closely printed figures in the record (see Rec., pages 13 to 18, inclu-

sive), and includes probably a little less than eight hundred items of money, varying in amounts. It took the experts some seven months to go through the books of the bank and cull out these dishonest items from the great mass of honest transactions.

An inspection of the exhibt shows that the experts set out the date of the dishonest transaction, the amount thereof, how it was accomplished; in brief, citing the book and page where and on which the item could be found. This exhibit was made a part of the bill. I will state just here that the guarantee company had been asked to put in an expert bookkeeper to assist in making out the exhibit, and declined to do so. Also the widow and administrator of Schardt had been likewise requested, and had done so.

This Exhibit X shows the default of Schardt, as cashier, to be $22,817.30, of which said item of $5,992.35 constituted a part. This Exhibit X constituted the proof of loss made to the guarantee company.

The following is the language of the bill:

"Complainant now charges that said Schardt, as such cashier, and during the currency of said bond, did, as shown by the report of said expert accountants and bookkeepers, and did, in fact, by acts of fraud committed by him in connection with the duties of his said office, and constituting embezzlement or larceny, take of said bank and appropriate to his own use, the sum of $22,817.30 without interest, and for which complainant is entitled to reimbursement under the terms and conditions of said bond."

The bill then proceeds to state that it did give notice, "and make the proof of the facts to said guarantee company."

While this Exhibit X was filed in court as a part of the bill, and a copy thereof in the hands of the guarantee company and its solicitors, it filed its answer, stating as follows:

"Respondent admits that after said bank made its assign-

ment to said Pryor, its affairs were examined, and it was discovered that said Schardt had *abstracted* from said bank a large amount of its money, a part of which was *abstracted* in the year 1890, a part of 1891, part in 1892, and a part in 1893, but the respondent does not admit that the amounts *embezzled* in each year are correctly stated in the bill," thus showing that defendant knew that every item of Exihibit X was charged as embezzlement.

The answer does not raise any issue on any item in said exhibit, or make the point now made, that the taking did not amount to an *embezzlement* or *larceny*. With the exhibit before defendant, the question should have been raised either in the answer, or certainly in the examination of witnesses, who testified to the correctness of the items in said exhibit as embezzlement or larcenies.

It is evident to the court that Exhibit X was the basis for the examination of the expert witnesses, and that it was not necessary to ask these witnesses if Schardt had embezzled or stolen such items *eo nomine*. The witnesses, the parties, and the attorneys went upon the theory that this exhibit contained the entire claim of complainant, and that each item was embezzlement or larceny. The experts headed the exhibit with these words: "Statement of shortage of John Schardt, cashier and teller of the Mechanics' Savings Bank & Trust Co."

The examination of the witnesses who made this exhibit, both original and cross, proceed upon the theory that "shortage" meant embezzlement or larcenies. Sometimes the word, "defaulter" is used. I give samples of the original and cross-examination:

Ques. 4, of McEwin. Witness was asked with reference to each and every one of the several hundred items of said exhibit: "Please state what was the character of these defaults, and of what did they consist as respects detention?

"Ans. They were extractions from the funds of the bank, made by Schardt, and were evidenced by the books kept by him, and covered on the books kept by him from detection.

"Ques. 5. Please state whether these abstractions or embezzlements were easily or readily detectible? etc.

"Ques. 7. How long were the bookkeepers and you engaged in ascertaining these abstractions?

"Ques. 9. In order to ascertain the facts of embezzlement of the funds of the bank? etc.

"Ques. 12. Please state whether the amounts, as stated above by you, were taken from the funds of the bank?

"Ans. These amounts mentioned were abstracted by John Schardt, etc."

On the cross-examination of this witness, the attorney for the company, Mr. Granbery, proceeding upon the idea that every item in Exhibit X was an embezzlement or larceny:

"Cross question 15. Please furnish statement marked Exhibit 4, showing in detail, the amount *embezzled* in each particular year, and each method."

The witness did so. It is alone in this Exhibit 4 that the aggregate of embezzlements, viz.: $5,992.35, done by means of overdrafts, first appears.

Record, p. 47.

In Exhibit X, each item of embezzlement is set out, but this does not, in every instance, show how it was done. Our friends on the other side wanted an exhibit showing, in brief, the amounts embezzled in each particular year, and the method by which each was accomplished. In this he was accommodated, said exhibits showing the amount of embezzlements each year, and the method by which it was done, such as "failure to credit deposit," "manipulating individual deposit," "failure to credit notes collected," "failure to enter deposit," etc., and then the items of $5,992.35, and the method by which it was done is stated to be "overdrafts allowed and not authorized." Our opponent's question called for embezzlement, and the method by

which it was accomplished. Now he seizes upon the method set out in the answer to show that it was not an embezzlement, but was money obtained in some mode discreditable, or otherwise, not amounting to an embezzlement.

I refer the court to the questions and answers of Prof. Jennings, who helped make out Exhibit X, and who, in response to the question, what was the result of the examination, said:

"I examined the books from September 9, 1890, to April, 1893, finding John Schardt's shortage during that time as teller and cashier, including interest, to be $107,182.12." He then sets out the amount for each year, and adds: "As cashier from January 1, 1893, to April 17, 1893, $22,964.17, and this item of $5,992.35, is included to make that sum."

Jennings stated the shortage of Schardt, as cashier, to be $22,964.17. He was then asked question 4:

"From whom had the money been taken or abstracted?
"Ans. From complainant bank.
"Ques. 5. Was the fact shown by books kept by Schardt, or which were under his care and keeping?
"Ans. Yes.
"Ques. 6. Was it shown to be money taken, or other valuables?
"Ans. As money taken.
"Ques. 7. How was Schardt shown to be connected with the embezzlement?
"Ans. The manipulations on the books were all shown to be in his handwriting."

The record abundantly shows that the whole testimony was taken upon the theory that Exhibit X showed only items of embezzlement or larceny.

2. On the trial and in the argument before the Circuit Judge (Clark), no such point was made, as the opinion reported in 68 Fed. Rep. shows. After Judge Clark had decided the case, and directed judgment to be entered for complainant, and the decree was prepared and submitted to the court, on July 1, 1895, the attorney for the company for the first time called the

attention of the court to this item, pointing out the present objection by error which he assigned August 1, 1895.

Neither the bill or the testimony made effort to hold Schardt or the company liable for "overdrafts," as such, but only for embezzlements or larcenies, but if Schardt made an overdraft on the bank in the name and behalf of another party, and without the knowledge of such party, or the bank, and himself took the proceeds and used them, it would be larceny or embezzlement on the part of Schardt, and the fact that it was called an "overdraft" by the experts would not make it a legitimate transaction, or deprive the transaction of its felonious character. Especially would this be true when the experts were asked to state the amount embezzled, and the method used by the embezzler.

The question concludes the particular criminality as that of embezzlement, and shows that the method by which it was accomplished was by overdraft.

This point was not made before the trial judge, and it was too late to assign it as error in the Court of Appeals, or in this court.

Danforth Dig., Vol. I., p. 1047, where all the cases are collected.

Marine Bank v. Fulton, 2 Wall., 252.

It is too late to present the question for the first time on a motion for a new trial.

Reagin v. Aiken, 138 U. S., 110.

Pacific Express Co. v. Malen, 132 U. S., 531.

We insist that under the rules of interpretation governing contracts of this character, that the bank would have the right of recovery for this item of $5,992.35, because of the ambiguity of the bond in its entirety, and that the guarantee company cannot insist that the act of fraud must amount to a technical "embezzlement" or "larceny."

The bond declares: "Whereas, the said employe has been appointed cashier at Nashville, Tenn., in the service of said employer, and has been required to furnish security that he shall not be guilty of any fraudulent act in the performance of his duties in said capacity, by which the said employer shall suffer pecuniary loss; and, whereas," etc. Later, and after many recitations in which the mind of the reader, especially of a layman, would have lost the connection, it says, it covenants to "reimburse unto said employer, or his or their representative or assigns, the amount of any loss, not exceeding in the whole the sum of twenty thousand dollars, which, during the currency of this bond, shall be sustained by the said employer by reason of any act of fraud committed by the said employe in connection with the duties of said appointment, and constituting embezzlement or larceny."

The sixth condition provides:

"This bond shall extend to cover only such losses as may have been incurred by reason of the fraud of the said employe during the currency and within twelve months previous to the notification to the said company of any default hereunder."

It is no answer to say, that, while the bond is ambiguous in respect to what acts the guarantee company will be liable for, in one place saying, "fraudulent acts, etc., by which the said employer shall suffer pecuniary loss;" at another place saying, "any acts of fraud, etc., constituting embezzlement or larceny," and at another place saying: "This bond shall extend to cover only such losses as may have been incurred by reason of the fraud of the said employe during the currency of this bond, and within twelve months," etc.

It will doubtless be replied to this that the first relates to the scope and obligations which the guarantee company is about to assume; that the next insertion relates to what it actually contracts to do, and that the third and last is a condition on the back of the bond relating to a limitation. It will not be denied, however, that the bond as a wole is ambiguous on this point, when read by the public generally, for whom it was intended.

This court has uniformly held:

"If, looking at all its provisions, the bond is fairly and reasonably susceptible of two constructions, one favorable to the bank and the other favorable to the surety company, the former, if consistent with the objects for which the bond is given, must be adopted, and for the reason that the instrument which the court is invited to interpret, was drawn by the attorneys, officers, or agents of the surety company."

American Surety Co. v. Paulz, 170 U. S., 133.
Imperial Fire Ins. Co. v. Core, 151 U. S., 452.

This bond more than once professes and pretends to secure the bank against loss by reason of the "fraud" and "fraudulent acts" of the employe, without regard to the technical criminal offense committed, and the public asked to accept it. The public have little or no concern, and less knowledge, of what constitutes the elements of larceny, embezzlement, or fraudulent breach of trust, or kindred crimes which go to make up the criminal laws of the country. The public wants indemnity against the wrongful and fraudulent appropriation and taking of money by parties intrusted, necessarily, with its custody and handling, as clerks, officers, etc., and to meet this want these bonds are made, accepted, paid for, and relied upon, and to this end they should be construed, unless there is a clear, unambiguous, and positive interdiction not reached by ingenious construction, but by the necessity of the very words used.

If the one part of the contract contradicts another part, then interpret the whole contract by the general purpose for which the contract has been made and entered into.

EDWARD H. EAST, *Attorney.*

APPENDIX.

Various Acts of the Legislature of Tennessee Licensing Dealings in Futures.

ACTS OF 1887 (pamphlet act), CH. 1, P. 13.

After naming the various and different occupations licensed, it says:

"FUTURES.

"Each person, firm, company, or corporation dealing therein, and each branch or agency of such firm, company, or corporation, per annum, $1,000.

ACTS OF 1889, CH. 130, P. 247.

"FUTURES.

"Dealers in futures, and brokers dealing in futures, whether actual delivery is intended or not, each person, firm, company, or corporation dealing or doing a brokerage association therein, and each branch or agency of such company or corporation in cities, taxing districts, or towns, of thirty thousand inhabitants, or over, per annum, $1,000."

This act then grades the amount of the license, according to population, of all towns under thirty thousand.

ACTS OF 1891, CH. 25, P. 50.

This act is the same as the Act of 1889, set out above.

Acts of 1893, Ch. 89, p. 131.

This act is the same as the Act of 1889, Ch. 130, set above.

There is a proviso to this act to the effect that it shall not be construed to amend, repeal, or modify the criminal laws of the State. Approved April 30, 1893.

These and similar acts were construed by the Supreme Court, in 16 Pickle, 79, holding the license valid.

Supreme Court of the United States.

No. 48.—October Term, 1901.

The Guarantee Company of North America, Petitioner, *vs.* The Mechanics' Savings Bank and Trust Company, for the use of J. J. Pryor, Assignee.	On writ of certiorari to the United States Circuit Court of Appeals for the Sixth Circuit.

[January 6, 1902.]

This was a bill in equity brought by the Mechanics' Savings Bank and Trust Company for the use of J. J. Pryor, assignee, against the Guarantee Company of North America, for an accounting and for a decree for the amount alleged to be due complainant on two bonds executed by the Guarantee Company to the bank; one insuring the latter corporation against such pecuniary loss as it might sustain by reason of the fraudulent acts of John Schardt, as teller and collector; and the other insuring the same corporation against pecuniary loss by reason of fraudulent acts committed by him in his office of cashier. On hearing a decree was rendered against the Guarantee Company on both bonds, 68 Fed. Rep. 459, which was affirmed on appeal. 47 U. S. App. 91. The case was then brought to this court by certiorari, and the decree of the Circuit Court of Appeals was reversed and the cause remanded on the ground that the decree of the Circuit Court was not final. 173 U. S. 587.

The Guarantee Company subsequently made an unsuccessful attempt to have the cause reopened for additional evidence alleged to have been discovered since the first decree. A final decree was rendered against the company, which, on appeal to the Circuit Court of Appeals for the Sixth Circuit, was modified and affirmed, 100 Fed. Rep. 559, and the present certiorari was then allowed.

The Mechanics' Savings Bank and Trust Company was a banking institution located at Nashville, Tennessee, with a capital of fifty thousand dollars. John Schardt was its teller from 1888 to January, 1893, when he was elected cashier and remained such until his death on April 17 following. As teller and cashier he embezzled more than one hundred thousand dollars of the funds of the bank, beginning in 1890 and continuing until about the time of his death. In discovering the defalcation the bank ascertained its insolvency, closed its doors, and made a general assignment for the benefit of its creditors.

The Guarantee Company of North America was a company organized under the laws of the Dominion of Canada, and engaged in the business

of guaranteeing pecuniary losses by the fraudulent acts of persons in positions of trust, and issued to the bank in 1888 a bond for the period of one year on Schardt as teller for ten thousand dollars, which was subsequently renewed each year until January, 1893, when it issued a bond on Schardt as cashier for twenty thousand dollars.

The defalcation of more than one hundred thousand dollars was occasioned by losses in speculation, and just prior to Schardt's death he assigned to the bank some property of slight value, and about eighty thousand dollars of life insurance as indemnity. From these collaterals the bank realized the sum of $46,448.86, and for the remainder of the default the company was held liable to the extent of each bond. On the second appeal to the Circuit Court of Appeals, that court found the default under the cashier's bond to have been some six thousand dollars less than as ascertained by the Circuit Court, and modified the decree accordingly.

The teller's bond was dated January 16, 1888, and described Schardt as the employé and the bank as the employer. It provided:

"Whereas, the employé has been appointed in the service of the said employer, and has been assigned to the office or position of teller and collector, by the said employer, and application has been made to the Guarantee Company of North America for the grant by them of this bond;

"And whereas, the employer has delivered to the company a certain statement, and it being agreed and understood that such statement constitutes an essential part of the contract hereinafter expressed:

"Now, therefore, in consideration of the sum of one hundred dollars lawful money of the United States of America, to the said company, as a premium for the term of twelve months, ending on the sixteenth day of January, 1889, at twelve o'clock, noon, and in order to effect a continuance of the currency of this bond, a like premium hereafter to be paid to the said company, on or before the sixteenth day of January in each year, as a premium for the ensuing year, so long as the said employer may wish to continue this bond, and the said company shall consent to receive said premiums, it is hereby agreed that the company shall, within three months after proof satisfactory to the directors, make good and reimburse to the employer such pecuniary loss as the employer shall have sustained by the fraudulent acts of the employé, in connection with the duties of his said office or position, or with any other duties assigned to him, by the employer in the said service, committed by him, and discovered during the continuance of the currency of this bond, and within six months from the employé's ceasing to be in the said service.

"The following provisions are also to be observed and binding as a part of this bond:

"The actual payment of the premium and its acceptance by this company either for the issue or renewal of this bond, is essential to its currency, and a condition precedent, to the right or claim hereunder.

"That this bond is issued and renewed on the express understanding that the employé has not within the knowledge of the said employer at any former period, either in this or other employment, been guilty of any default or serious dereliction of duty.

"That the employer shall observe or cause to be observed all due and customary supervision over the said employé for the prevention of default, and if the employer shall at any time, during the currency of this bond, condone any act or default, on the part of the employé, which would give the employer the right to claim hereunder, and shall continue the employé in his service, without notification to the company, the said company will not be responsible hereunto for any default which may occur subsequent to said act or default of said employé, so condoned.

"That the employer shall at once notify the company on his becoming aware of the said employé being engaged in speculation or gambling, or indulging in any disreputable or unlawful habits or pursuits.

"That there shall be an inspection or audit of the accounts or books of the employé on behalf of the employer at least once in every twelve months from the date of this bond.

"That the company shall be notified in writing of any act on the part of said employé, which may involve a loss for which the company is responsible hereunder to the employer, immediately or without unreasonable delay, after the occurrence of such act shall have come to the knowledge of the employer; and upon the making of such a claim, this bond shall wholly cease and determine as regards any liability, for any act of the employé committed subsequent to the making of such claim, and shall be surrendered to the company on the payment of all claims due hereunder.

* * * * * *

"That the company may cancel this bond at any time, by notifying the employer and refunding the premium paid less a *pro rata* part thereof for the time said bond shall have been in force; but said cancellation shall not affect or impair the company's liability hereunder for any acts committed or discovered previous to such cancellation during the currency of this bond, and within three months after said cancellation."

* * * * * *

The statement referred to was signed by the then cashier and delivered to the company before the bond was issued. It commenced with a communication from the managing director of the Guarantee Company, desiring answers to certain accompanying questions. These answers were given by the cashier, who also declared his answers and representations to be true, and that he was "not aware of any matter or thing affecting the character or reputation of the applicant, which should create any doubt as to his reliability or trustworthiness." This bond was renewed each year up to January, 1893, and in each year before the bond was renewed, the company furnished the bank with a blank form, to be filled out, and stating: "It is necessary before the bond can be renewed that you obtain the certificate on the back hereof by your president or cashier and on its return with remittance of the premium, the renewal can be immediately effected."

The certificate on the back was filled up and signed by the cashier, and among other things stated that the accounts of said teller Schardt had been examined and verified by the finance committee of said bank; and the bond was not renewed in any year until this certificate had been made out and delivered to the company.

Before the cashier's bond was issued the company "submitted for reply on behalf of the bank," certain questions, addressed to the president, which, and the answers thereto by the president as such, are referred to in the bond as "employers' guarantee proposal No. 154,806." Among these questions and answers were the following:

"Q. 2. If a new employé, by whom was the applicant introduced, or how did he become known to you? If hitherto in continuous service, for how long, in what capacities, and has he uniformly performed his duties faithfully and satisfactorily?—A. Applicant began service in this bank six years ago as collector —— cl'k, and has since been advanced to bank's teller and now cashier.

"Q. 3. Has he ever been in arrears or default in the bank's service, or, as far as you have heard, in any previous employment?—A. No.

"Q. 4. Have you known or heard anything unfavorable as to his habits or associations, past or present?—A. No.

"Q —. Or of any matters concerning him about which you deem it advisable for the company to make inquiry?—A. No.

"Q. 5. Is he to your knowledge pecuniarily embarrassed or insolvent? Or is he in any way indebted to the bank?— —. ——.

"Q. 6. Is he now or about to be engaged in any other business or employment than in the bank's services?—A. No.

"Q. 7. Applicant's position or capacity for which this bond is required? —A. Cashier.

"Q. 8. Amount of his salary or other emoluments, if any?—A. $2,000 per annum.

"Q. 9. Amount or bond hereby required, from what date to commence, and by whom premium will be paid?—A. $20,000 to date from Jan. 1, 1893. Premium payable by bank.

"Q. 10. What further security, if any, will be held or required from applicant?—A. None.

"Q. 11. Have you hitherto held other security from applicant? If so, why discontinued or changed to this?—A. Formerly teller and general bookkeeper in this bank; elected cashier at annual meeting January 1, 1893.

"Q. 12. Has there been any fault in the bank by any employé in applicant's position?—A. No.

"Q. 13. When were applicant's books and accounts (including cash, securities and vouchers, if any) last examined, and by whom?—A. December 31, 1892, by finance committee (were they found correct) of bank and found correct.

"Q. 14. In case of applicant handling cash or securities, how often will the same be examined and compared with the books, accounts and vouchers, and by whom?—A. Not less than quarterly, and often monthly, by finance committee.

"Q. 15. In case of applicant acting as teller: (*a*) Will he be required to balance his cash daily, and report same to president or cashier? (*b*) And will a record of same be kept?—A. * * *

"Q. 16. Will applicant handle funds or securities not subject to a routine check, or periodical examination? If so, please describe their nature?—A. No."

"The above answers and representations are true to the best of my knowledge and belief."

The cashier's bond was then executed and delivered to the bank, and provided:

"Whereas the said employé has been appointed cashier at Nashville, Tennessee, in the service of the said employer and has been required to furnish security that he shall not be guilty of any fraudulent act in the performance of his duties in the said capacity, by which the said employer shall suffer pecuniary loss, and whereas the said company, in consideration of the sum of one hundred dollars, now therefor paid for the term expiring January 1, 1894, and for the purposes of the renewal of this contract the sum or premiums of one hundred dollars, hereafter to be therefor paid to the said company, on or before the first day of January, 1894, and a like payment for each and every succeeding term of one year, so long as the said company shall consent to receive it—hath agreed upon the terms, and subject to the provisos and conditions hereinafter contained and endorsed thereon, hereby to become such security to the said employer:

"Now, therefore, this bond witnesseth, that the said employé for and on his own behalf and the said company fully relying on the truth of the statement and declaration contained in a certain document distinguished as employer's guarantee proposal No. 154,806, dated the 10th day of Jan., 1893, and signed Lewis T. Baxter, president on behalf of the said employer, and lodged with the said company at its office in Montreal, and on the strict performance and observance hereafter, by the said employer of the contract thereby created, do hereby, respectively, severally and jointly covenant with the said employer to reimburse unto the said employer or his or their representatives or assigns, the amount of any loss not exceeding in the whole sum of twenty thousand dollars, which, during the currency of this bond, shall be sustained by the said employer by reason of any act of fraud committed by the said employé in connection with the duties of said appointment and constituting embezzlement or larceny—such reimbursement to be made within three calendar months next after proof shall have been given to the satisfaction of the directors of the said company, of the occurrence of such loss, and the proof thereof to include, if the company shall so require, an affidavit to be made or taken by the person, for the time being entitled to the benefit of this guarantee, to the effect that he hath been actually defrauded by the said employé, and that he suffers absolute and ultimate loss thereby to the full amount claimed hereunder, and that the contract created as aforesaid hath been fully performed and observed on the part of the said employer.

"Provided always, that this bond and guarantee hereby granted or undertaken, shall be subject and liable to the terms and conditions hereupon endorsed."

Among the terms and conditions referred to were these:

"This bond is granted upon the following express conditions:

"1. Any misstatement of a material fact, in the declaration within mentioned, or in any claim made under this bond, will render this bond void from the beginning.

"2. That the said employer shall use all due and customary diligence in the supervision of said employé for the prevention of default, and to

that end shall cause an inspection or audit of his accounts to be made at least once within twelve months, and if the said employer shall at any time during the currency of this bond, become aware of any act or default on the part of said employé which would constitute a claim hereunder, and shall continue said employé in his service without notification to the said company, the said company will not be responsible hereunder for any loss or default which may occur subsequent to said act or default of said employé.

"3. That any written answers or statements made by or on behalf of said employer in regard to or in connection with the conduct, duties, accounts or methods of supervision of the said employé delivered to the company either prior to the issue of this bond, or to any renewal thereof, or at any time during its currency, shall be held to be a warranty thereof, and form a basis of this guarantee, or of its continuance.

"4. That the said employé has not, to the knowledge or belief of said employer, been guilty of any serious dereliction of duty, or default in this or any other service, or that his habits have been such as to incur said employer's censure, previous to the issue of this bond.

"5. The said employer shall, immediately, upon it becoming known to him or them, that the said employé has been guilty of any act entitling the said employer to claim under this bond, notify the said company, at its head office; and this bond shall become absolutely void, both as to existing and future liability if the said employer shall neglect or omit to so notify the said company.

* * * * * *

"8. That in addition to the supervision to be exercised by the said employer as mentioned in the statement and declaration within referred to the said company shall be afforded every reasonable facility to examine from time to time as they may desire, for the purposes of this bond, the books, papers and affairs of the said employer entrusted to the keeping and charge of the said employé."

It appeared from the evidence that Schardt defaulted as teller and collector from September 12, 1890, to January 1, 1893, in the sum of $78,819.24, subdivided as follows: From September 1, 1890, to January 16, 1891, $5,879.34; from January 16, 1891, to January 1, 1892, $22,290; from January 1, 1892, to January, 1893, $50,649.90; and as cashier, from January 16, 1893, to April 15, $22,964.17.

The principal books of the bank were: A general ledger, showing generally the accounts of the bank, including the account in totals of the deposits made and checked out daily; a cash book, giving each day's business; a daily balance book, which was a summary of the general ledger; these three books were kept by Schardt; and an individual ledger, which showed in detail the deposit account of each individual depositor, and was kept by a clerk, who had no other duties, and was known as individual bookkeeper. The aggregate of the amounts due each depositor shown on the individual ledger and the totals due depositors on the general ledger and daily balance book should have agreed, but this they did not do because, after the latter part of 1890, the general ledger and

daily balance book did not correctly show the amount due to all depositors, although the individual ledger correctly gave the amount due to each depositor. Up to the latter part of 1890 trial balances were taken from the individual ledger every two weeks, or once a month, and entered in a trial balance book, and these balances were compared with the balances on the general ledger and any differences settled and corrected, but at that time Schardt told the individual bookkeeper that it was not necessary to take off trial balances any longer, and thereafter none were taken off. Schardt, as teller, abstracted the funds of the bank and understated on the general ledger the amount due to depositors by the amount he abstracted. The difference in the balances represented the shortage at the respective dates. The individual and general ledger were out of balance January 16, 1891, $2,098; January 1, 1892, $19,600, and January 1, 1893, $69,700.

The leading expert accountant testified that he was employed to examine the books on April 15, 1893, and went to the bank on the morning of that day between eight and eight thirty o'clock, and that by four o'clock that afternoon he had discovered that while the daily balance book kept by Schardt showed less than $18,000 due depositors, the individual ledger from "A" to "L," (leaving "M" to "Z" to be examined) showed an indebtedness due depositors of in the neighborhood of $55,000. He reported at once that something was radically wrong; although it required considerable time subsequently to ascertain the exact condition of the bank.

Quarterly examinations of the bank's condition were made by the finance committee, but the individual bookkeeper was not requested to furnish the total amount shown on the individual ledger to be due depositors. The committee "examined no book except the daily balance sheet, with which we compared the reports as made out by Schardt." "Q. In what way could you tell that the amounts reported by Schardt were correct? A. We only had his word for it and the reports that he made to us and the exhibit on the daily balance book." "Q. In what way did you verify the statement on the book kept by Schardt which would have shown and purported to show the amount due individual depositors? A. We made no verification of it only in the manner in which I have stated. Q. Have you stated any manner in which you verified this particular account? A. We took his word for it, which we had to do or go into an examination of all the books."

Schardt also abstracted proceeds of notes paid to him as teller. This shortage was not concealed on the books. The amount of notes in the bank did not equal the amount called for by the books by the amount abstracted.

January 1, 1892, the books showed a defalcation of $28,169.34, of which $19,600 was abstracted deposits and $3,765.44 proceeds of notes

collected and not accounted for. January 1, 1893, the books showed a defalcation of $78,819.24, of which $69,700 was abstracted deposits and $4,015.44 proceeds of notes collected.

The following evidence was also introduced:

Charles Sykes, who was the cashier of the bank from January, 1890, to January, 1893, testified:

"Q. 6. Did you at any time during that year receive information that John Schardt was speculating; if so, state when, how and all the circumstances?—A. Yes, sir; I did receive such information. Some time in the summer or fall of 1892 a gentleman by the name of Kyle came here from New York, representing Myers & Co., of New York. Kyle wanted me to become interested in the brokerage business and represent Myers & Co. at this point. I told him that I did not like the idea because it would be purely a speculative business, and he then said that that made no difference; that John Schardt, our teller, was a part owner in a similar concern.

"Q. 7. Did you impart this knowledge to any one; if so, whom?—A. Yes, sir; I once told Mr. L. T. Baxter, the president of the bank, of the conversation.

"Q. 8. Did you say anything to Schardt about the matter?—A. Yes, sir; on the next day, I think I told Mr. Schardt of what Kyle had said.

"Q. 9. What did Schardt say to you in reply?—A. He admitted that he had at one time been interested in such a concern, but had sold his interest; and that he had speculated to some extent, but had made money on every transaction, and had seen the error of his way, and had ceased to do so any more.

"Q. 10. Did you impart this information received from Schardt to any one connected with the bank, if so, whom?—A. Yes, sir; I immediately told Mr. Baxter, the president of the bank, what Schardt had said.

"Q. 11. Did you receive any other information at any other time with reference to Schardt's speculating?—A. Yes, sir; some time thereafter I received an anonymous letter telling me that Schardt had been speculating.

"Q. 12. What did you do with it and what became of it?—A. I showed it to Mr. L. T. Baxter, the president, and he said not to pay any attention to an anonymous letter, and I spoke to Schardt about it, and he said he thought he knew the author, and asked me to let him have the letter, and he would bring the party before me and make him acknowledge it was false.

"Q. 13. Did you give him the letter and did he bring the party before you?—A. I gave him the letter, and asked him about it more than once, and he always replied that he was working on it.

"Q. 14. Did you tell Mr. Baxter of this conversation?—A. I think I did."

On cross examination the witness said there was litigation pending between him and the bank's assignee; that he signed several applications for the renewal of Schardt's bond as teller, relying on the fact that the finance committee said his accounts were correct; that he did not remember that he recommended Schardt as his successor to Porter or Duncan, though he might have, and if Mr. Porter said that he did, he supposed he did. Mr. Porter testified that he asked Sykes about Schardt's ability; "there was no question as to his integrity."

J. M. Eatherly testified that he had been a director of the bank from its organization until its assignment; a member of the finance committee for several years prior to being elected president, and president from March 28 to April 17, 1893.

In answer to questions from complainant's counsel in respect of an interview with Schardt on the evening of April 15, 1893, he said:

"I told him that we had come out for the purpose of getting an explanation as to the discrepancies mentioned above. I told him we had found errors in his books. He said, 'Mr. Eatherly, my books are correct.' I told him that I did not see how he could reconcile the two things that we had found the daily balance sheet showing something less than $18,000 due depositors, while the individual ledger, as far as had been examined by Mr. McEwan and Mr. Richardson, showed about $55,000 due depositors. He reiterated that his books were absolutely correct. I said, 'John, I cannot understand it that way.' I was satisfied there was an error somewhere. I asked Mr. Richardson if he wanted to ask him any question. He was silent a moment or two, and said, 'I don't know that I do.' He then turned to Mr. Schardt, and said: 'John, I am bound to say to you that you are a defaulter.' Mr. Schardt broke out into a cry, putting his hands over his face, and said: 'My God! it is true—too true.' I said: 'John, compose yourself; we have come here for facts and want facts.' I then asked him how much was his default and he said about $40,000. I told him if the other individual ledger showed the same proportion of discrepancy that this one did, that he was a defaulter to a much larger amount—I would say to not less than $60,000 or $70,000. He said, 'Mr. Eatherly, you are mistaken. It cannot be that much.' I then asked him how he had lost it, and he said, 'Speculating in New York, and you can get it all back.' He said, 'you,' meaning the bank. I said, 'No, John, we can do no such thing; the laws of New York legalize this sort of trading, and we cannot recover it in that way.'"

On cross examination he testified:

"Q. 98. Did you ever hear of Schardt's speculating before January, 1893?—A. I think I did.

"Q. 99. Did you see the anonymous letter written with respect to his speculating?—A. I saw a letter directed to Judge John Woodward. Judge Woodward brought that letter to the bank and showed it to me, and I asked permission to call Mr. Schardt up and show it to him, and he said that he was perfectly willing that I should do so. I at once called Mr. Schardt to where we were and told him there was a communication I wanted him to read. He did so, and his remarks were: 'It is a lie and I can prove it.' In this letter it was stated that Mr. Schardt was a partner in a bucket shop. I told Mr. Schardt that it devolved on him to prove it false. I at once reported the contents of this letter to the president of the bank, Mr. Baxter. Mr. Schardt asked that I and Judge Woodward remain there for a few minutes. He went out and got Frank Searight and Dr. Barry. Judge Woodward, Mr. Baxter and myself went into the rear of the bank building. Mr. Schardt and the other gentlemen came back, and Mr. Schardt says: 'Here are men who can tell you whether that is so or not.' I asked them if they knew why we had sent for them, and they said that Mr. Schardt had told them. Mr. Searight said some time

before that Mr. Schardt, Dr. Barry and himself had agreed to open a brokerage association. They objected very much to the term bucket shop. Each one was to put in a small amount—$200, I think. Mr. Schardt, in a short time, became dissatisfied and sold his interest to Frank Searight at a small loss. Subsequent to that I went to Mr. Schardt's house to see him, having heard again that he was speculating. I told him what I had heard and he said it was not so, that he did not own any stocks at all. I told him if he was he ought to quit that or quit the bank, and he said he had sold everything he had. I again heard that he was speculating, but from sources that I did not attach any importance to, as it all emanated from the same source as the anonymous letter. I again approached him and he denied it.

"Q. 100. Was this just prior to the resignation of Judge Woodward as a member of the board?—A. I think it was.

"Q. 101. Do you know when he resigned?—A. His resignation bears date Feb. 17, 1893. Was placed before the board of directors and accepted March 25, 1893.

"Q. 102. Did Mr. Baxter, the president, ever say anything to you about Schardt speculating?—A. I don't think he ever did."

The general agent of the company at Nashville testified that Schardt's bond as cashier was cancelled through him on April 15, he having ascertained that Schardt had been speculating in futures; that he had not heard of any defalcation or wrongdoing on the part of any employé of the bank other than this; and that the company did not bond persons holding a fiduciary position, who speculated in futures, as they had found from experience that the risk was not safe.

There was evidence that Schardt had borne a good reputation for honesty, integrity and industry; and of experts that, without trial balances from the individual ledger, the true condition of the bank could not be known; and that to verify accounts meant to apply some other test than the statements of those who kept them.

Mr. Chief Justice FULLER delivered the opinion of the Court:

The teller's bond, as originally given, expired January, 1889, and was renewed from year to year. Before each renewal, the bank was informed by the company that it was necessary that a certain certificate by the president or cashier should be furnished, which was done, and stated, among other things, that the accounts of the teller had been examined and verified by the finance committee of the bank. The bond provided that it was issued and renewed "on the express understanding that the employé has not within the knowledge of the said employer at any former period either in this or other employment been guilty of any default or serious dereliction of duty;" "that the employer shall observe, or cause to be observed, all due and customary supervision over the said employé for the prevention of default;" and that there shall be "an inspection or

audit of the accounts or books of the employé on behalf of the employer at least once in every twelve months from the date of this bond."

The company, not unnaturally, contends that as when the bond was renewed in January, 1892, the bank's books showed that the employé was a defaulter in the sum of $19,600 understated liabilities, and of $3,765.44 abstracted from bills receivable, both of which could have been detected by the taking of a trial balance as is customary, or a mere comparison between the books kept by Schardt and the individual ledger, and a correct footing of the notes, the bank had not only not complied with its engagements above referred to, and falsely certified to a verification which in fact had not been had, but was guilty of such laches as in itself to defeat a recovery.

These are matters which, while not controlling our decision, should be considered in connection with that aspect of the case which we regard as decisive.

In addition to the provisions already mentioned, it was agreed "that the employer shall at once notify the company, on his becoming aware of the said employé being engaged in speculation or gambling, or indulging in any disreputable or unlawful habits or pursuits."

The legislation of Tennessee and the decisions of its courts placed dealing in futures, when either party did not contemplate delivery, in the category of gambling, and aimed to suppress it. *Allen* v. *Dunham*, 92 Tenn. 257; *McGrew* v. *City Produce Exchange*, 85 Tenn. 578; *Palmer* v. *State*, 88 Tenn. 553; Acts 1883, c. 251.

The evidence showed that in the summer or fall of 1892 the cashier of the bank was told that the teller was part owner in a concern engaged in speculative business; he at once informed the president of the bank; and also called Schardt's attention to the matter, who admitted that he had once been engaged in such a concern, but said he had sold out, and also that he had speculated to some extent but had ceased to do so. The cashier further testified that he afterwards received an anonymous letter that Schardt was speculating, and showed it to the president; that he spoke to Schardt about it; that the latter said he thought he knew the author, and asked for the letter, that he might bring the party before the cashier and make him acknowledge that it was false. The letter was given him but nothing came of it, although he was asked about it more than once. This conversation was reported to the president. A leading director and a member of the finance committee was shown by another director an anonymous letter to him, to the same effect, which was reported to the president. The letter stated that Schardt was in partnership in a bucket shop. Schardt said it was a lie, and brought his partners before the president and the two directors, and they said that they had opened a brokerage association with Schardt, but that Schardt had sold out. This director subsequently heard again that Schardt was speculating and went

to Schardt's house and interviewed him, and he said he did not own any stocks at all, he had sold everything he had. He heard this again shortly after the cashier's bond was given, and Schardt again denied it. Complainant did not put the president of the bank on the stand.

In these circumstances was it the duty of the bank to notify the company of what it had heard?

In *American Surety Company* v. *Pauly*, 170 U. S. 133, 144, which was an action against the maker of a bond given to insure a bank against loss arising from acts of fraud or dishonesty on the part of its cashier, the applicable rule was thus laid down:

"If, looking at all its provisions, the bond is fairly and reasonably susceptible of two constructions, one favorable to the bank and the other favorable to the surety company, the former, if consistent with the objects for which the bond was given, must be adopted, and this for the reason that the instrument which the court is invited to interpret was drawn by the attorneys, officers or agents of the surety company. This is a well established rule in the law of insurance. . . . As said by Lord St. Leonards in *Anderson* v. *Fitzgerald*, 4 H. L. Cas. *484, *507, 'it [a life policy] is of course prepared by the company, and if therefore there should be any ambiguity in it, must be taken, according to law, most strongly against the person who prepared it.' There is no sound reason why this rule should not be applied in the present case. The object of the bond in suit was to indemnify or insure the bank against loss arising from any act of fraud or dishonesty on the part of O'Brien in connection with his duties as cashier, or with the duties to which in the employer's service he might be subsequently appointed. That object should not be defeated by any narrow interpretation of its provisions, nor by adopting a construction favorable to the company if there be another construction equally admissible under the terms of the instrument executed for the protection of the bank."

But this rule cannot be availed of to refine away terms of a contract expressed with sufficient clearness to convey the plain meaning of the parties, and embodying requirements compliance with which is made the condition to liability thereon.

Whatever the common law duty on the part of the employer to notify the guarantor of the fraud or dishonesty of the employé, whose fidelity is guaranteed, the parties to this contract undertook to declare the duty of the bank to the company in certain specified particulars. It required that the employé should not have been guilty of previous default or dereliction *within the knowledge* of the employer. It provided for notification of any act of the employé which might involve a loss without unreasonable delay after the occurrence of the act came *to the knowledge* of the employer. And it required immediate notification on the employer *becoming aware* of the employé being engaged in speculation or gambling. The words, "becoming aware," were manifestly used as expressive of a different meaning from having "knowledge."

In Pauly's case, where the bond required that the company should be notified in writing "of any act on the part of the employé, which may involve a loss for which the company is responsible hereunder, as soon as practicable after the occurrence of such act may have come to the knowledge of the employer," it was ruled that it had been properly held "that the surety company did not intend to require written notice of any act upon the part of the cashier that might involve loss, unless the bank had knowledge, not simply suspicion, of the existence of such facts as would justify a careful and prudent man in charging another with fraud or dishonesty."

But the bond before us not only contained that clause but the clause under consideration, which was a different and additional clause intended to secure the safety of prevention through timely warning.

It seems to us that the obvious meaning of "becoming aware," as used in this bond, is "to be informed of," or, "to be apprised of," or, "to be put on one's guard in respect to," and that no other meaning is equally admissible under the terms of the instrument. These are the definitions of the lexicographers, distinctly deducible from the derivation of the word "aware," and that is the sense in which they are here employed. It is used in the same sense in the cashier's certificate on the renewals of the teller's bond.

To be aware is not the same as to have knowledge. The bond itself distinguishes between the two phrases and uses them as not synonymous with each other. And, in view of the plain object of the clause, we cannot regard the words as equivalent to "becoming satisfied," though perhaps they may be to "having reason to believe." Even then these facts would have demanded investigation or notification, for we think the bank cannot be heard to say it did not have reason to believe that Schardt was speculating when it took his professions of repentance as sufficient assurance that he had ceased speculating, and turned its back on any independent inquiry or investigation. Our understanding of the provision is that what the company stipulated for was prompt notification of information by the bank in regard to speculation or gambling on the part of the employé. It was entitled to exercise its own judgment on that information and had not agreed to rely on the bank's belief in that regard. It had the right to investigate for itself whether the bank did so or not. Notification of the existence of reason for inquiry was exactly what the clause was intended to secure. The bank neither investigated nor gave the company notice of the information it had, and substituted its own judgment as to the value of that information for that of the company. In our view this conduct on its part amounted to a breach of the stipulation.

The Circuit Judge in his opinion said: "The language of the bond is that the employer shall report 'on his becoming aware of the employé being

engaged in speculation.' Without now stopping to consider at length the meaning of the terms here used, I am of opinion that, in the absence of fraud or bad faith, the failure to disclose the result of the inquiry made in this instance did not invalidate the bond as to the surety. Certainly, speculation in a reasonable and substantial sense is meant, such in length of time or magnitude as would make it serious. This, when brought to the attention of the bank officials, was a past event, and apparently in itself unimportant. The bank was under no duty by the contract or independently of it to actively institute or prosecute inquiries about Schardt, or to run down loose rumors or anonymous letters." 68 Fed. Rep. 459, 465.

The Circuit Court of Appeals said: "There is not the least evidence of any bad faith on the part of any of these officers of the bank, including Sykes, the old cashier, in not making a disclosure of what was known, but only of bad judgment in not being more considerably affected by their information." 47 U. S. App. 115.

These quotations show that the Circuit Court of Appeals and the Circuit Court concurred in the opinion that if the president and directors had such confidence in Schardt that they did not feel called upon to make any investigation in view of the information that they had received, or to notify the company of that information, and were not guilty of intentional bad faith, then the bank could not be held to have violated the stipulations of the bond on its part.

As will have been seen, we are unable to accept this conclusion. The company's defense did not rest on the duty of diligence growing out of the relation of the parties, but on the breach of one of the stipulations entered into between them. The question was not merely whether the conduct of the bank was contrary to the nature of the contract, but whether it was not contrary to its terms. Engagement in speculation or gambling was what the company sought to guard against because experience had admonished it of the probability that speculation or gambling would lead to acts involving loss for which it would be responsible. Bad faith in the view of the courts below would not exist if the bank had such confidence in Schardt's integrity that it accepted his bare statement that he was not speculating as overcoming the weight of his admission that he had been. How anything but such a denial could be expected it is not easy to see, nor how careful and prudent men could have been justified in omitting independent inquiry.

The truth is that in spite of strict supervision and the pursuit of the best systems of keeping accounts, there is always a risk of defalcation. The prevention of defaults or their detection at the earliest possible moment are of even more vital importance to financial institutions than to the guarantors of the fidelity of their employés. The provisions intended to

protect the company in this case were not in themselves unreasonable and so far as they operated to compel the bank to exercise due supervision and examination, and due vigilance, were consistent with sound public policy. We think it was the duty of this bank to have made prompt investigation, or at all events to have notified the company at once of the information that it had, and we decline to hold that the bank's misplaced confidence in Schardt affords sufficient ground for enforcing the liability of the surety company on the theory of good faith.

Our conclusion is that the failure of the bank in the particulars adverted to defeats a recovery on the teller's bond for defalcation after information of Schardt being engaged in speculation was received.

It also results that there can be no recovery at all on the cashier's bond. If the bank had observed the stipulation in the teller's bond to which we have referred, it is obvious that there would have been no cashier's bond, and the question would not have arisen. But this it did not do, and the bond was given. The bond provided that the company covenanted with the bank in reliance on the statement and declaration of the president on behalf of the bank, and on the bank's strict observance of the contract; that any misstatement of a material fact in the declaration should invalidate the bond; that the bank should use "all due and customary diligence in the supervision of said employé for the prevention of default;" "that any written answers or statements made by or on behalf of said employer in regard to or in connection with the conduct, duties, accounts or methods of supervision of the said employé delivered to the company either prior to the issue of this bond, or to any renewal thereof, or at any time during its currency, shall be held to be a warranty thereof, and form a basis of this guarantee, or of its continuance."

Two of the questions and answers in the declaration were as follows:

"Q. Have you known or heard anything unfavorable as to his habits or associations, past or present?—A. No.

"Q. Or of any matters concerning him about which you deem it advisable for the company to make inquiry?—A. No."

In Pauly's case, the president and the cashier were confederates in the dishonesty of the cashier, for the purpose of defrauding the bank; and also it was held no part of the duties of the president under the circumstances there disclosed to certify to the integrity of the cashier as he did. In this case the dishonesty was that of the cashier alone; the statements were required to be and were made on behalf of the bank, and the president acted for the bank in so doing; and the bonds were procured by the bank, and the bank paid the premiums. There can be no doubt that the bank was responsible for the representations of its cashier in the one instance and its president in the other in procuring these contracts of indemnity. The representations made in the declaration on which the

cashier's bond was issued were clearly misrepresentations. The teller's bond required notification if the bank were informed of speculation on Schardt's part. The president had heard of such speculation, and knew that speculating was something unfavorable as to Schardt's habits; and the president of course knew that the matters concerning him, of which he had heard, were such as it was advisable for the company to make inquiry about. True, the second question was if he had heard of matters about which he deemed it advisable for the company to inquire and the word "deem" might be said to give a considerable discretion, but it was not a discretion to be abused. That the company would consider it advisable to make inquiry is too plain for argument. The whole tenor of the bond renders any other conclusion impossible.

We cannot regard the representations of the president as consistent with good faith, and he was not even called as a witness by the bank to explain his conduct, if he could have done so.

The decrees of both courts are reversed, and the cause remanded to the Circuit Court for further proceedings consistent with this opinion.

True copy.

Test:

Clerk Supreme Court, U. S.